Supreme Court, U.S.
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No.

In The
Supreme Court of the United States
October Term, 1995

KNAPP SHOES INC.,
Petitioner,
v.
SYLVANIA SHOE MANUFACTURING CORPORATION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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April 11, 1996

BATEMAN & SLADE, INC. BOSTON, MASSACHUSETTS

131P.

QUESTIONS PRESENTED

1. May a federal appeals court affirm a lower court decision based on a fact-specific affirmative defense that neither was plead in accordance with Fed.R.Civ.P. 8(c) nor litigated below, but was raised by the appeals court *sua sponte*?

2. Under Fed.R.Civ.P. 52(a), may a federal appeals court make *de novo* factual determinations concerning an unplead and unlitigated affirmative defense and may that court place the burden of proof for such defense on the plaintiff, contrary to applicable state law?

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

The parties to this proceeding are as listed in the caption. Pursuant to Rule 29.6 of this Court's rules, petitioner states that it is a subsidiary of Chamberlain Phipps Group, PLC.

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PETITION FOR A WRIT OF CERTIORARI

Knapp Shoes Inc. respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the First Circuit in this case.

OPINIONS BELOW

The opinion of the Court of Appeals entered in conjunction with the judgment sought to be reviewed (App., *infra*, 1a-30a) is reported at 72 F.3d 190. An earlier opinion of the Court of Appeals in the same case (App., *infra*, 91a-106a) is reported at 15 F.3d 1222. The opinion of the District Court (App., *infra*, 31a-85a) is unreported.

JURISDICTION

The Court of Appeals entered its judgment on December 20, 1995. On January 12, 1996, the Court of Appeals entered an order denying a timely petition for rehearing. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISION AND PROCEDURAL RULES INVOLVED

The relevant statutory provision is Mass. Gen. Laws Ann. ch. 106, § 2-715(2)(a) (West 1990), which is the Massachusetts version of Section 2-715(2)(a) of the Uniform Commercial Code ("U.C.C. § 2-715(2)(a)"). It is reproduced in full in the Appendix. (App., *infra*, 108a). The relevant procedural rules are Fed.R.Civ.P. 8(c) and 52(a), which are reproduced in full in the Appendix. (App., *infra*, 108a-109a).

STATEMENT

A. *Statutory and Procedural Framework*

U.C.C. § 2-715(2)(a) defines consequential damages, such as lost profits, which result from a seller's breach as including "any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know *and which could not reasonably be prevented by cover or otherwise*." MASS. GEN. LAWS ANN. ch. 106, § 2-715(2)(a) (West 1990) (emphasis added). Most courts considering the question have concluded that the highlighted language incorporates the common law duty to mitigate.

Fed.R.Civ.P. 8(c) requires a party to plead affirmatively certain specified defenses and "any other matter constituting an avoidance or affirmative defense." Most federal courts, including the First Circuit, have concluded that failure to mitigate damages is an affirmative defense under Fed.R.Civ.P. 8(c). This Court has upheld a finding that a failure to raise an affirmative defense under facts similar to those in this case is a waiver of that defense.

Fed.R.Civ.P. 52(a) provides that, in all cases tried upon the facts without a jury, an appeals court shall not set aside the lower court's findings of fact unless clearly erroneous. This Court's decisions arising under Fed.R.Civ.P. 52(a) establish that the role of an appeals court with respect to findings of fact is limited. In particular, when the record is devoid of evidence on an issue, an appeals court may not make its own findings of fact, especially when the issue has not been addressed by the lower court or by the parties. The finding at issue here, the reasonableness of a buyer's efforts to mitigate its damages, is one of fact under controlling state law.

B. *Facts and Proceedings Below*

Petitioner Knapp Shoes Inc. ("Knapp") is a Massachusetts corporation engaged in the business of selling work shoes on a wholesale and retail basis. Respondent Sylvania Shoe Manufacturing Corporation ("Sylvania") at all relevant times was a Pennsylvania corporation engaged in the manufacture of shoes. From September 1987 through February 1990, Sylvania manufactured over 250,000 pairs of work shoes for Knapp. Knapp contended at trial and on appeal that a high percentage of the shoes were defective because the soles separated from the upper part of the shoe during wear. Throughout their business relationship, Sylvania assured Knapp that it would remedy any defects. When it became clear in February 1990 that Sylvania would not (or could not) deliver a consistently reliable product, Knapp terminated the relationship.

On April 10, 1990, Knapp commenced the within action in the United States District Court for the District of Massachusetts, alleging, *inter alia*, that Sylvania had breached the implied warranties of merchantability and fitness for a particular purpose under the U.C.C. by manufacturing and selling Knapp defective shoes. Among other relief, Knapp sought damages in the form of lost profits. Jurisdiction was based on diversity of citizenship, pursuant to 28 U.S.C. § 1332. Both parties consented to proceed before a magistrate judge without a jury. Trial took place over 15 days in January, June, and November 1991.

On March 1, 1995, the district court issued its opinion. It found Sylvania had breached its implied warranties by selling defective shoes, but that the defect rate was low, only three to four percent (3-4%). The district court thus denied Knapp's claim for lost profits of $2,895,326, finding that, because the defect rate was so low, Knapp had failed to prove any lost profits. (App., *infra*, 77a-79a).

The district court did not suggest in its opinion that Knapp had acted unreasonably under U.C.C. § 2-715(2)(a) in relying on Sylvania's representations that it would deliver quality shoes or in continuing to buy shoes manufactured by Sylvania. Rather, the district court concluded that because the defect rate among the Sylvania shoes was so low, Knapp's best course of action to minimize any lost profits would have been to *continue* its relationship with Sylvania. (App., *infra*, 81a).

Knapp appealed the judgment to the United States Court of Appeals for the First Circuit, which issued its opinion on December 20, 1995. The Court of Appeals set aside as clearly erroneous the district court's finding that only three to four percent (3-4%) of the shoes were defective. (App., *infra*, 22a-25a). The Court of Appeals found the record supported a defect rate of 41.7% among the shoes sold by Sylvania, and awarded Knapp damages in the amount of $477,538.09.

In spite of the high defect rate, the Court of Appeals affirmed the district court's decision denying lost profits. The Court of Appeals did agree with Knapp's contentions that the high defect rate had a detrimental impact on Knapp's business and that Knapp had lost customers and thus had lost future sales and profits. (App., *infra*, 27a). The Court of Appeals, however, made a *de novo* factual determination that because the defect rate was *so high*, Knapp had not acted reasonably within the meaning of U.C.C. § 2-715(2)(a) and therefore was not entitled to lost profits. The Court of Appeals found as a matter of fact that Knapp had demonstrated no urgent need for the Sylvania shoes and thus, in the face of such a high defect rate, had acted unreasonably in continuing to buy shoes from Sylvania and in failing to switch to another supplier during the 1987-1989 time period. In other words, the Court of Appeals as a matter of fact found that Knapp had failed to cover and had failed to prove it had mitigated its lost profits damages.[1] (App., *infra*, 26a-27a).

On January 4, 1996, Knapp filed a petition for rehearing with the Court of Appeals arguing, *inter alia*, that Sylvania neither had raised nor litigated the reasonableness of Knapp's conduct in mitigating its damages and that Sylvania, not Knapp, bore the burden of proof on the issue. In its petition, Knapp proposed that the Court of Appeals remand the case for an evidentiary hearing, if necessary, to resolve any issues of fact concerning mitigation. The Court of Appeals denied the petition for rehearing on January 12, 1996. On March 21, 1996, the district court issued an amended judgment in accordance with the opinion of the Court of Appeals.

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[1] This was the first time this issue had been raised in the almost six (6) years of proceedings in this case, and the ruling of the Court of Appeals — that Knapp had failed to mitigate during the pre-1990 time period — must be distinguished from the district court's curious finding concerning cover and mitigation *after* Knapp had terminated Sylvania in 1990. *See infra* note 4.

REASONS FOR GRANTING THE PETITION

This Court should grant review to resolve an important question of federal procedure concerning the authority of a federal court of appeals to raise *sua sponte* an affirmative defense that neither was plead in accordance with Fed.R.Civ.P. 8(c) nor litigated in the district court, to make its own findings of fact concerning that new defense, and to deny a plaintiff relief based on those findings. In this case, the Court of Appeals denied Knapp its lost profits based on Knapp's allegedly unreasonable behavior in failing to terminate its relationship with Sylvania earlier than it had and in failing to seek out another supplier. Because the Court of Appeals raised the mitigation issue *sua sponte*, Knapp was deprived of the opportunity to address whether Sylvania had waived the mitigation defense, either by failing to plead it or by its trial strategy,[2] or, alternatively, to offer evidence to controvert the factual issues underlying this unplead and unlitigated affirmative defense.

This Court's decisions establish the authority of a federal appeals court to affirm a lower court decision on any ground *supported in the record*. Indeed, federal appeals courts have, on occasion, affirmed a lower court decision based on an affirmative defense not raised below, but only when the affirmative defense is strictly a matter of law and does not rest upon evidence the parties could have presented had the issue properly been raised. This Court, however, has not established the circumstances under which, as a matter of fundamental fairness, an appeals court must find that failure to raise a defense constitutes a waiver or, alternatively, the extent to

[2] Generally, an affirmative defense that is neither plead nor litigated is waived. *Knapp Shoes, Inc.* v. *Sylvania Shoe Mfg. Corp.*, 15 F.3d 1222, 1226 (1st Cir. 1994). In a slightly different context, this Court has addressed the issue of waiver under Fed.R.Civ.P. 8(c) with respect to lost profits and upheld a finding that an unplead and unlitigated affirmative defense had been waived. *Zenith Radio Corp.* v. *Hazeltine Research, Inc.*, 401 U.S. 321 (1971).

which an appeals court must provide a litigant an opportunity to present evidence on a fact-specific affirmative defense that is raised for the first time after trial. This Court should grant review to settle these questions which go to the heart of proper appellate procedure and raise the issue of fundamental fairness in the judicial process.

This Court also should grant review in order to correct a decision which clearly conflicts with the principles of appellate review established by this Court. Contrary to the decisions of this Court, the Court of Appeals based its decision denying lost profits on a factual finding that Knapp had acted unreasonably in continuing to do business with Sylvania, a factual determination which was contrary to that of the district court, which was contrary to the position advocated strenuously throughout the litigation by Sylvania, which the Court of Appeals had no authority to make, and which has no support in the record. Moreover, in ruling upon the "reasonableness" of Knapp's efforts to mitigate, the Court of Appeals erroneously placed the burden of proof on Knapp, contrary to controlling state law. These errors by the Court of Appeals represent such a departure from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's supervisory power.

I. The Court of Appeals Erred in Denying Knapp's Lost Profits Based on an Affirmative Defense That Neither Was Plead in Accordance With Fed.R. Civ.P. 8(c) Nor Litigated Below.

Fed.R.Civ.P. 8(c) requires a party to plead affirmatively certain specified defenses and "any other matter constituting an avoidance or affirmative defense." In *Blonder-Tongue Lab.* v. *University of Illinois Found.*, 402 U.S. 313 (1971), this

Court explained that the purpose of requiring such pleading is to give the opposing party notice of the defense and an opportunity to develop evidence and offer arguments to controvert the defense. *Id.* at 350. Some courts have excused noncompliance with the pleading requirements of Fed.R.Civ.P. 8(c) if a plaintiff otherwise has received notice of an affirmative defense and was not prejudiced by the omission of the defense from the initial pleading, *e.g.*, *Moore, Owen, Thomas & Co.* v. *Coffey*, 992 F.2d 1439, 1445 (6th Cir. 1993), or when the defense has been fully tried under the express or implied consent of the parties as if it had been raised in the original responsive pleading. *Federal Deposit Ins. Corp.* v. *Ramirez-Rivera*, 869 F.2d 624, 626 (1st Cir. 1989). Absent these particular circumstances, however, an affirmative defense is deemed waived if not plead in accordance with Fed.R.Civ.P. 8(c). *See Zenith Radio Corp.* v. *Hazeltine Research, Inc.*, 401 U.S. 321, 329-33 (1971); *Knapp Shoes, Inc.* v. *Sylvania Shoe Mfg. Corp.*, 15 F.3d 1222, 1226 (1st Cir. 1994). The reason for this is clear: it would be fundamentally unfair to give a defendant the benefit of a defense of which the plaintiff received no notice and therefore did not litigate.

In this case, Sylvania neither plead nor litigated the mitigation issue. Indeed, mitigation through cover would have been an anathema to Sylvania and its theory of the case — Sylvania adamantly asserted throughout the trial and on appeal that the percentage of defects was quite low and conceded Knapp no consequential damages. *See Zenith Radio Corp.*, 401 U.S. at 803. Knapp presented substantial evidence that it had lost customers and sales as a result of the high rate of defects, that those customers otherwise would have continued to buy from Knapp for at least a five-year period, and that the profits on

those lost sales would have been $2,895,326.[3] Never in response to Knapp's claims did Sylvania contend that Knapp should have mitigated its damages by buying shoes elsewhere. Rather, Sylvania vigorously challenged the claimed high defect rate and disputed Knapp's claim that it had incurred damages as a result of such defects.

The district court agreed with Sylvania, finding that the number of defects was so insignificant that Knapp had suffered no lost profits as a result. To the extent that Knapp had suffered damages, the district court found that Knapp should have "minimized" such damages "by simply continuing its relationship with Sylvania." (App., *infra*, 81a).

The Court of Appeals overturned the district court's finding on the number of defects as clearly erroneous and held that the evidence established a defect rate of 41.7%. (App., *infra*, 24a-25a). The Court of Appeals nevertheless denied Knapp its lost profits, because it found that in the face of such a high defect rate Knapp had acted "unreasonably" within the meaning of U.C.C. § 2-715(2)(a) in not terminating Sylvania much earlier than it had and finding a new supplier, although the Court of Appeals did not specify when, precisely, Knapp should have terminated Sylvania. (App., *infra*, 26a-27a). This was the *first* time the issue of the reasonableness of Knapp's mitigation efforts had been raised, and it was the *first* time anyone had suggested Knapp should have terminated Sylvania earlier than it had.[4] Although Sylvania neither plead nor liti-

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[3] Knapp also presented evidence that *after* it had terminated its relationship with Sylvania in 1990, it purchased replacement shoes from an overseas supplier to fill the orders of those customers who continued to do business with Knapp. Knapp still lost significant profits, however, because some customers from the pre-1990 period refused to buy Knapp's shoes after thier experience with the shoes Sylvania manufactured. It was these lost profits which formed the basis of Knapp's claim.

[4] While the district court stated, in passing, that "the evidence presented by plaintiff is simply barren of any indication that it made any reasonable effort whatsoever to *seek* a covering contract as a *predicate* to recovering lost profits," (App., *infra*, 81a) (emphasis original), this statement related only to Knapp's conduct

gated failure to mitigate, the Court of Appeals failed to address whether Sylvania thereby waived the defense.[5]

In *Helvering* v. *Gowran*, 302 U.S. 238 (1937), this Court expressed the general rule that when there are stipulated or undisputed facts in the record, an appeals court may affirm on any ground *supported by that record*, even if the grounds for the affirmance have not been raised below. *Id.* at 245-47. The reason for this rule is obvious: when there is no need for additional evidence, it would be wasteful to send a case back to the lower court to reinstate a decision which the district court already had made but which the appeals court determined should have been made on different legal grounds. Yet, this Court also recognized in *Gowran* that, as a matter of fairness, when the new issue on appeal is fact-based and has not been litigated below, the case should be remanded to afford an opportunity to present additional facts which might affect the outcome. *Id.* at 247.

This case presents precisely the circumstances under which it is fundamentally unfair for an appeals court to affirm based on a defense not raised below. The affirmative defense at issue here, whether Knapp acted reasonably in an effort to mitigate its lost profits damages is a highly fact-specific defense of which, assuming *arguendo* that it was not waived, Knapp should have received notice and an opportunity to controvert.

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after it had terminated its relationship with Sylvania in 1990 and had no bearing on the "reasonableness" of Knapp's conduct in 1988 and 1989, the period on which the Court of Appeals focused. Indeed, unlike the Court of Appeals, the district court did not question the reasonableness of Knapp's actions before 1990.

[5] Had the Court of Appeals provided the parties with an opportunity to address the mitigation issue rather than impermissibly making its own factual determination, Knapp would have been able to address fully whether Sylvania's failure to plead under Fed.R.Civ.P. 8(c) and its failure to litigate the mitigation issue had constituted a waiver. *See Knapp Shoes, Inc.* v. *Sylvania Shoe Mfg. Corp.*, 15 F.3rd 1222 (1st Cir. 1994). Knapp also would have had an opportunity to address the need for further evidence if it was determined the defense had not been waived.

Under the principles established in *Gowran*, an appeals court may affirm on grounds different from those relied upon by the district court only when the facts upon which the affirmance rests are stipulated or undisputed. *Gowran*, 302 U.S. at 247. When the facts are in dispute, or, as in this case, the facts have not been presented because the affirmative defense was never raised, the case must be remanded. To allow the Court of Appeals' decision in this case to stand would undermine the principles on which Fed.R.Civ.P. 8(c) is based. As it did in *Gowran*, this Court, as a matter of fairness, should remand the case for a determination on waiver or, alternatively, for the submission of additional evidence on the new issue raised by the Court of Appeals.

II. The Court of Appeals Departed From Well-Established Principles of Appellate Review When it Engaged in its Own Fact-Finding.

This Court's decisions establish that the role of an appeals court with respect to findings of fact is very limited. In a case tried without a jury, the task of the appeals court is to determine whether the lower court's findings are clearly erroneous under Fed.R.Civ.P. 52(a). *Zenith Radio Corp.* v. *Hazeltine Research, Inc.*, 395 U.S. 100, 123 (1969). An appeals court may not decide factual issues *de novo*. *Id.* Rather, if the court of appeals determines that the findings of the lower court are clearly erroneous, then it may substitute *undisputed* facts of record for the lower court's findings. *United States* v. *United States Gypsum Co.*, 333 U.S. 364, 398 (1948). What an appeals court may not do under Fed.R.Civ.P. 52(a), however, is assume the role of fact-finder and engage in a *de novo* weighing of the evidence in the record. *Anderson* v. *Bessemer City*, 470 U.S. 564, 574 (1985) ("in applying the clearly erron-

neous standard [of Fed.R.Civ.P. 52(a)] to the findings of a district court sitting without a jury, appellate courts must constantly have in mind that their function is not to decide factual issues *de novo*") (quoting *Zenith Radio Corp.* v. *Hazeltine Research, Inc.*, 395 U.S. 100, 123 (1969)). When the correctness of the lower court decision depends on a determination of fact which only the fact-finder could make but which has not been made, an appellate court cannot take the place of the fact-finder. *SEC* v. *Chenery Corp.*, 318 U.S. 80, 88 (1943). If the appeals court believes the lower court has failed to make findings of fact essential to the proper resolution of a legal question, it should remand to the lower court to make those findings. *Icicle Seafoods, Inc.* v. *Worthington*, 475 U.S. 709, 714 (1986).

In this case, the Court of Appeals, in affirming the lower court's denial of Knapp's lost profits, engaged in its own fact-finding with respect to mitigation of damages rather than remanding. The lower court's denial of lost profits was inextricably linked to its conclusion that only a small percentage of the shoes were defective, a conclusion which the Court of Appeals set aside as clearly erroneous. Having set that finding aside, the Court of Appeals focused on a new issue and substituted its own finding that Knapp had acted unreasonably within the meaning of U.C.C. § 2-715(2)(a) by failing to terminate its relationship with Sylvania earlier than it had and by failing to find a new supplier.[6]

Undoubtedly eager to bring this protracted litigation to a close[7] and apparently unwilling to remand this case to the

[6] There is no question that the reasonableness of Knapp's conduct in this regard is a question of fact. *Newman* v. *Redstone*, 354 Mass. 379, 383, 237 N.E.2d 666, 669 (1968) (ordinarily, the reasonableness of an actor's conduct is a question of fact).

[7] Knapp filed suit in 1990 and the case was tried in 1991. Despite an admonition from the Court of Appeals in February 1994 that the case had been ripe for resolution "at least since March 1992," the district court did not render its decision until March 1995. The appeal below represented the third appellate proceeding, two in the Court of Appeals and one in the Massachusett Supreme Judicial Court.

lower court for an evidentiary hearing on the reasonableness of Knapp's conduct, the Court of Appeals impermissibly decided to make its own findings. Inevitably, this impermissible foray into fact finding by the Court of Appeals has led to other, unresolved factual issues. For example, the Court of Appeals, while finding Knapp had not acted reasonably and had not mitigated its lost profits, did not address the issue of *when* Knapp's conduct in continuing to do business with Sylvania had become unreasonable. Was Knapp required under the U.C.C. to terminate Sylvania immediately upon delivery of the *first* defective shoe or was it instead justified, at least for a time, in working with Sylvania to eliminate sole separations? During the period when the parties were attempting to solve the problem with the shoes, Knapp already had begun to lose customers, and thus, profits. Under the applicable U.C.C. provisions, Knapp would be entitled to recover those lost profits incurred while it was still acting "reasonably." That factual determination could be made only by the trial court after the parties had an opportunity to present their evidence.

The Court of Appeals exceeded the limits of its authority under Fed.R.Civ.P. 52(a) and under the decisions of this Court. This Court should grant review to correct the Court of Appeals' decision. Alternatively, this Court should grant the petition for writ of certiorari, vacate the judgment, and remand the case to the Court of Appeals for further consideration in light of Fed.R.Civ.P. 52(a) and the decisions of this Court. *See Dennison Mfg. Co.* v. *Panduit Corp.*, 475 U.S. 809 (1986).

III. The Court of Appeals Failed to Follow Controlling State Law When it Erroneously Placed the Burden of Proof of Mitigation on Knapp.

This Court's decision in *Erie R.R. Co.* v. *Tompkins*, 304 U.S. 64 (1938) mandates that a federal court sitting in diversity

apply the substantive law of the forum state, absent a federal statutory or constitutional directive to the contrary. *Id.* at 78. Under *Erie*, the question of which party bears the burden of proof on a particular issue in a diversity case is a matter of state law.

U.C.C. § 2-715(2)(a), while clearly requiring that a buyer attempt to mitigate damages, does not address the issue of which party bears the burden of proof with respect to mitigation. MASS. GEN. LAWS ANN. ch. 106, § 2-715(2)(a) (West 1990). Neither is the issue addressed in any other section of the Uniform Commercial Code. According to the official comment to U.C.C. § 1-103, the common law of contracts shall apply unless explicitly displaced by a U.C.C. provision. MASS. GEN. LAWS ANN. ch. 106, § 1-103 (West 1990). Therefore, in a diversity case decided under U.C.C. 2-715(2)(a), the burden of proof on mitigation rests with the defendant, as it would under the common law of contracts in Massachusetts. *Maynard* v. *Royal Worcester Corset Co.*, 200 Mass. 1, 6, 85 N.E. 877, 879 (1908); *American Mechanical Corp.* v. *Union Machine Co.*, 21 Mass. App. Ct. 97, 103, 485 N.E.2d 680, 685 (1985) (burden of proving that losses could have been avoided by reasonable effort rests with party in breach). *See also* 2 ROBERT L. DUNN, RECOVERY OF DAMAGES FOR LOST PROFITS § 6.22 (4th ed. 1992) (proof of failure to mitigate damages is a matter for the defense); 1 ROY R. ANDERSON, DAMAGES UNDER THE UNIFORM COMMERCIAL CODE § 4.12 (1992) (defendant has the burden of proof with respect to matters in avoidance of damages or in mitigation thereof).

In placing on Knapp the burden of proving mitigation and the reasonableness of its conduct after the delivery of defective shoes had commenced, the Court of Appeals failed to follow state law and disregarded a fundamental principle of federal

law, established by this Court in *Erie*.[8] This error by the Court of Appeals represents such a departure from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's supervisory power.

CONCLUSION

The petition for a writ of certiorari should be granted. If appropriate, this Court may grant the petition, vacate the judgment and remand to the Court of Appeals for further consideration in light of Fed.R.Civ.P. 8(c) and 52(a) and applicable state law.

Respectfully submitted,

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April 11, 1996

[8] Knapp does not mean to suggest that the Court of Appeals deliberately refused to follow controlling state law on the burden of proof. But, by engaging in its own fact-finding and not permitting the parties an opportunity to fully address the law and the facts, the Court of Appeals nevertheless did fail to follow state law.

APPENDIX

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 95-1220

KNAPP SHOES, INC.,
PLAINTIFF-APPELLANT,

v.

SYLVANIA SHOE MANUFACTURING CORPORATION,
DEFENDANT-APPELLEE.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS.
[HON. LAWRENCE P. COHEN, U.S. MAGISTRATE JUDGE]

Before
Cyr, Boudin and Lynch,
Circuit Judges.

Bernard J. Bonn III with whom *Timothy C. Blank*, *Kara W. Swanson* and *Dechert Price & Rhoads* were on briefs for appellant.

Joseph B. Green with whom *Steven L. Katz* and *Kotin, Crabtree & Strong* were on brief for appellee.

December 20, 1995

BOUDIN, *Circuit Judge*.

Over the course of three years, beginning in early 1987, Knapp Shoes, Inc. ("Knapp") purchased nearly 300,000 pairs of shoes from Sylvania Shoe Manufacturing Corp. ("Sylvania"). The relationship between the two companies underwent strains during its final year, and broke off early in 1990. Knapp filed suit in April 1990 claiming that Sylvania had manufactured defective shoes: Sylvania counterclaimed for unpaid bills. In March 1995, the magistrate judge awarded net damages of less than $65,000 in favor of Sylvania. Knapp appeals. We affirm in part, reverse in part, and remand for the entry of a new judgment as specified in this opinion.

I. THE UNDERLYING FACTS

Knapp, a Massachusetts corporation, manufactures and distributes work shoes. In addition to selling and distributing shoes that it manufactures, Knapp also sells and distributes shoes manufactured by other shoe companies under the Knapp logo. Sylvania, a Pennsylvania corporation, was one such supplier to Knapp.

In late 1986, Jack Esser, then Knapp's vice president for merchandising and manufacturing, told Knapp personnel to contact Sylvania to arrange for the manufacture of shoes Knapp was selling to the U.S. Postal Service. Sylvania delivered over 10,000 pairs of two styles of shoes — models 1249 and 1250 — by mid-February 1987. By all accounts, there were few problems with these shoes, nor were there problems with over 5,000 pairs of 1249s between September 1987 and May 1988.

Thus encouraged, Sylvania and Knapp expanded their collaboration, and by early 1988 Sylvania had made or was making over two dozen models of shoes for Knapp. These later models all differed in construction from the 1249s and 1250s. While the

latter in each case consisted of a leather upper cemented to a polyurethane sole, the new models were constructed of three parts: a rubber outsole, an ethyl vinyl acetate (EVA) midsole, and a leather upper. Among Knapp's various problems with Sylvania shoes, the most serious complaint was that the leather upper and the EVA midsole tended to fall apart.

The bulk of Knapp's purchases were in three categories. The first, style 1251, accounted for nearly 25,000 pairs. These shoes were athletic-style postal shoes. The second category was the 2600 series, which accounted for over 140,000 pairs. These shoes were steel-toed shoes, intended for use in industrial settings where OSHA regulations required protective footwear. The final category was the 2800 and 2900 series of non-steel-toe shoes, of which perhaps 70,000 pairs were sold. A number of models that Sylvania produced for Knapp are not implicated in this litigation.

Quality control problems with shoes in these three lines appeared almost immediately and continued throughout the history of the two companies' relationship. In mid-1987, Knapp found that the toe bumpers of style 2600 were improperly bonded to the shoe and could be peeled off; these shoes were returned to Sylvania for repair before being shipped to Knapp's customers. A further problem — this time with sole adhesion — appeared soon afterwards, affecting white shoes in the 2600 and 2800 lines. Sylvania, on the advice of its cement company, had in late 1987 added white pigment to the cement for cosmetic reasons, and this seemed to affect the bond. This difficulty led to the recall of thousands of shoes in early 1988.

By summer 1988, the sole separation problems had spread to black shoes. In a letter sent by John Sprague, the individual at Knapp charged with quality control and product development, to Colin Elliot, a vice president at Sylvania, Sprague

wrote that the problems reported with the black shoes "scare[s] the hell out of us" and reported also that a "[r]ash of telephone calls" had complained of sole separations on style 1251. Following these complaints, a number of shoes were sent to the Footwear Institute of America for pull testing.[1] These tests indicated that some sole adhesion problems were caused by improper manufacture.

Esser later testified that he concluded at the time that the problems were minimal and he authorized continued purchases from Sylvania. However, both Sprague and Esser remained in almost daily contact with Elliot in an effort to correct the defects. In addition, Knapp began to place a legend on the bottom of some of its purchase orders, "ORDER PENDING CORRECTION OF SOLE SEPARATION PROBLEM."

Throughout this period, the evidence indicates that Sylvania and Knapp worked together to attempt to solve the problems that were affecting the shoes. Various design changes were suggested by Knapp, and Sylvania implemented many of them. The suggestions included adding toe bumpers to models that lacked them and substituting a polyurethane midsole for the EVA midsole in certain models. In addition, Sylvania changed cement companies in mid-1988.

In 1989, the relations between the two companies began to deteriorate. Sylvania blames this deterioration on Knapp's then-parlous financial state. Knapp established a cash committee in February 1989 (of which John Esser was a member); Richard Nedder, Knapp's president, was replaced by Joel Murray in April. Knapp fell behind on its account with Sylvania,

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[1] Pull tests, standard in the industry, allow for measurement of the strength of shoe construction. In addition to measuring the pounds of pressure that can be applied to a particular area of the shoe before it will fail, the tests indicate whether the failure was caused by material failure — a tearing of the upper or of the sole — or by a bond failure.

prompting Sylvania president Robert Pearlstein to send letters of complaint in the summer of 1989.

Knapp insists that defects in Sylvania shoes were jeopardizing some of its most important accounts and it offered evidence that failures in models 2810 and 2930 were of particular concern. In the summer of 1989 Knapp attempted to return 1000 pairs of 2810s that were produced with the EVA midsole; Sylvania refused to accept the returns. At trial, Sylvania offered evidence, credited by the magistrate judge, that many of these 2810 and 2930 shoes were not manufactured by Sylvania, but were instead imported by Knapp from Taiwan. There was also evidence that sole adhesion problems affected some models that were never produced by Sylvania.

In an effort to work out a payment schedule, Pearlstein met with Murray and others at Knapp twice in the summer and fall of 1989. At the latter meeting on October 17, Knapp sought to demonstrate that there were quality problems with Sylvania shoes by twisting the soles and uppers apart manually. This was done, but the ease, and the significance, of the demonstration were disputed. At that meeting, Knapp agreed to pay $40,000 for every $35,000 of product sent by Sylvania, the extra $5,000 being part of Knapp's attempt to repay earlier amounts owed to Sylvania.

Records of both companies show that shipments continued in October and November 1989. Payments were also made by Knapp against its outstanding balance in January 1990. On December 1, 1989, Dick Sebastiao joined Knapp as executive vice president with the understanding that he would become president in February 1990. By the end of 1989, Sprague had been fired and Esser, who had been on the board of directors of the company, also had left.

A final shipment of Sylvania shoes was delivered in February 1990, after Knapp made an advance payment. James Crabtree,

a Knapp employee, testified that when the shoes were inspected, he was able to pull them apart with his bare hands; he alerted Sebastiao, who called Pearlstein at Sylvania. Pearlstein asked for a sample to inspect, and disputed Crabtree's findings. The magistrate judge later found Crabtree's testimony incredible and credited Pearlstein's assertion that the shoes in the February 1990 shipment were not defective, although two Sylvania employees — Elliot and John Cartwright (Sylvania's manufacturing supervisor) — admitted that they had been able manually to separate the soles on some of the shoes.

Crabtree further testified that he then began to test Knapp's existing inventory of Sylvania shoes and found that it was "95% defective." Again, this testimony was not credited by the magistrate judge. Knapp also performed various tests on the shoes from the February shipment and on shoes in inventory after the start of litigation; its evidence at trial was that these tests consistently found problems with the bonding of the shoes. This evidence was also not credited by the magistrate judge.

PRIOR PROCEEDINGS

On April 10, 1990, Knapp filed this diversity action against Sylvania under Massachusetts law for breach of contract (count 1), breach of express warranty and implied warranties of merchantability and fitness for a particular purpose (counts 2-4), breach of the duty of good faith and fair dealing (count 5), fraud and negligent misrepresentation (counts 6 and 7), and violation of Mass. Gen. L. c. 93A (count 8).[2] Sylvania also counterclaimed, seeking $277,000 for unpaid bills, plus multiple damages and attorney's fees under c. 93A.

Both parties consented to proceed before a magistrate judge without a jury, and the magistrate judge bifurcated the trial into

[2] Chapter 93A outlaws "[u]nfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade of commerce," and permits awards of multiple damages and attorney's fees.

a liability phase and a damage phase. Evidence in the liability phase was completed on January 31, 1991, after nine days of testimony. That same day, the magistrate judge entered a four-page memorandum and order that devoted one paragraph each to five of Knapp's eight counts, without discussing Sylvania's counterclaims.

In this decision, the magistrate judge ruled that Sylvania had breached its warranties only insofar as Knapp had shown, or could show, that shoes delivered to it were defective. The magistrate judge also found that Knapp had failed to prove fraud, negligent misrepresentation or — "except to the extent that plaintiff has shown, or can show," a refusal by Sylvania to credit returned defective shoes — breach of the duty of good faith and fair dealing. As for Knapp's c. 93A claim, the decision said that Sylvania had not been shown to have engaged in unscrupulous conduct; it noted, but did not decide, the question whether some payments might still be due Knapp under c. 93A based on a regulation of the state's attorney general.

In May 1991, prior to the damages phase of the trial, Knapp learned that Sylvania was going out of business and liquidating its assets. Fearful that Sylvania would soon be judgment-proof, Knapp obtained a temporary restraining order precluding Sylvania from dissipating assets in the amount of $3,775,657.22 — the amount of damages that Knapp hoped to prove in the damage phase of the trial. The magistrate judge modified this order on June 10, 1991, converting it into a preliminary injunction and amending it to allow Sylvania to make limited payments to its creditors and lawyers.

The damages phase of the trial took place over five days in June 1991; at Sylvania's behest, an additional day of evidence was heard on November 25, 1991. Proposed findings of fact and conclusions of law were filed by the parties in March 1992.

Then, in March 1993, the magistrate judge issued an order proposing to certify certain questions to the Massachusetts Supreme Judicial Court. Both sides opposed certification, but on April 8, 1993, the magistrate judge certified two questions, both relating to the possible application of c. 93A to "a single breach of warranty."

The magistrate judge prefaced the certified questions with a ten-page statement. In it, he first repeated the rulings on the five counts contained in the January 31, 1991, order. Then, he determined for the first time that the parties had agreed by express negotiations, express understandings and express course of dealings that in the event of defects, "Knapp's remedy, and *sole* remedy, would be the replacement of [or credit for] those shoes shown to be defective and returned — nothing more, and nothing less" (footnote omitted; brackets in the original). The certification also said, in a footnote, that less than three percent of the Sylvania shoes delivered to Knapp were defective.

On Sylvania's motion, the magistrate judge dissolved the preliminary injunction on May 5, 1993, concluding that Knapp now had little hope of a substantial recovery. On Knapp's appeal, this court stayed and then vacated the order dissolving the preliminary injunction. *Knapp Shoes, Inc.* v. *Sylvania Shoe Manufacturing Corp.*, 15 F.3d 1222 (1st Cir. 1994). We held that Sylvania had waived the affirmative defense of limitation of remedies by failing to raise it in a timely fashion. Since the issue of limitation of remedies had never been litigated by the parties, the waiver could not be avoided by amending the pleadings to conform to the proof. *Cf.* Fed. R. Civ. P. 15(b). Accordingly, we said that "the limitation of remedies defense is out of the case and cannot support the order vacating the injunction." *Id.* at 1227.

We also rejected Sylvania's alternative argument that the termination of the injunction could be supported by the magistrate judge's footnote finding, in the certification, that the percentage of defects was very small. Our opinion pointed out that the magistrate judge had not set forth findings or analysis to support this conclusion as to the quantity of defects, so we were "unable to make a reasoned judgment whether, on this critical issue of defects, the magistrate judge's finding was or was not 'clearly erroneous' " under Fed. R. Civ. P. 52(a). *Id.* at 1228-29.

On October 13, 1994, the Supreme Judicial Court answered the certified questions that had been submitted by the magistrate judge. *Knapp Shoes, Inc.* v. *Sylvania Shoe Manufacturing Corp.*, 640 N.E.2d 1101 (Mass. 1994). The Court held that 940 Code Mass. Regs. § 3.08, which provides in part that "[it] shall be an unfair and deceptive act or practice to fail to perform or fulfill any promises or obligations arising under a warranty," was not meant "to encompass a contract dispute between businessmen based on a breach of the implied warranty of merchantability." *Id.* at 1105.

Thus informed, the magistrate judge issued his final decision on March 1, 1995. With respect to counts 3 and 4 (breach of warranties of merchantability and fitness), he again held that Sylvania had breached its warranties to the extent that particular shoes were defective for whatever reason. On count 1 (breach of contract), the magistrate judge said again that there was no violation beyond the breaches of warranty covered by counts 3 and 4. He also reaffirmed that Knapp had failed to establish its claims in count 2 (breach of express warranties), count 5 (duty of good faith and fair dealing), count 6 (common law fraud), count 7 (common law negligent misrepresentation) and count 8 (Mass. Gen. L. c. 93A violation).

On Sylvania's counterclaims, the magistrate judge found that Knapp was liable for the outstanding balance due for shoes that Sylvania had delivered to Knapp. The magistrate judge found that Sylvania was not entitled to recover the contract price of additional shoes it had manufactured for Knapp but not yet delivered; the reason was that Sylvania had failed to make a reasonable effort to resell the shoes. He also rejected Sylvania's own c. 93A claim against Knapp. Sylvania does not challenge these rulings on appeal.

In computing damages, the magistrate judge held that Knapp should receive credit only for defective shoes still in its inventory — which he determined to be between 3 and 4 percent of the total — and for specified incidental damages. He ruled that Knapp had no right to revoke acceptance of any non-defective goods in inventory, nor to reject the final shipment of shoes sent in February 1990, nor to recover for lost profits. In the final tally, Knapp was awarded damages of $160,062.74, and Sylvania was awarded damages of $223,626.47. Finally, the preliminary injunction was dissolved. We stayed the judgment pending disposition of this appeal.

LAW OF THE CASE AND STANDARD OF REVIEW

Our review of the facts found by the trial judge is normally deferential; findings are not to be set aside unless clearly erroneous, with "due regard . . . given to the opportunity of the trial court to judge of the credibility of the witnesses." Fed. R. Civ. P. 52(a); *see Williams* v. *Poulos*, 11 F.3d 271, 278 (1st Cir. 1993). Knapp argues that our review should be less deferential in this case, drawing attention to paragraph 49 of the magistrate judge's findings of fact and its accompanying footnote.

> [Paragraph 49] With respect to all lines of shoes which Knapp requested be manufactured by Syl-

vania, one finding is unmistakenably [*sic*] clear: By their express negotiations, by their express understandings, by their demonstrated conduct, and by their express course of dealings, Sylvania promised Knapp that, in the event that shoes were defectively manufactured, Knapp's remedy, and *sole* remedy, would be the replacement of [or credit for] those shoes shown to be defective and returned — nothing more, and nothing less.

[Footnote] This finding is not made and reported to suggest that Knapp waived its rights under §§ 2-601, 2-608, and 2-609 of the Uniform Commercial Code (G.L. c. 106, §§ 2-601, 2-608 and 2-609). Although it was and is clear to this court — then and now — that that was the sole understanding of the parties in terms of remedies and relief, and that it was clear (then and now) to all parties that the defense of waiver loomed throughout, and that plaintiff could not — then or now — establish any *legal* prejudice (that is, plaintiff could not — then or now — make any showing that the case would have been tried differently), our Court of Appeals, in the context of an interlocutory appeal relating to the dissolution of an injunction, has concluded otherwise.

Nevertheless, this finding and conclusion bear heavily on the credibility of the witnesses called by Knapp, and other issues to be determined herein.

Knapp argues that this discussion violates the law of the case by contradicting our holding in *Knapp* that Sylvania had waived any such limitation of remedies defense, that the issue of limitation of remedies had not been litigated at trial, and that it was now "out of the case." 15 F.3d at 1227. Knapp further insists that this error by the magistrate judge tainted his

other factual findings, requiring us to subject these findings to heightened scrutiny. Paragraph 49 has certainly complicated matters on this appeal, but we conclude that Knapp has somewhat exaggerated its import and consequences.

The law of the case doctrine has more than one dimension and certain complexities, but as applied to the problem before us, the doctrine provides that when a court of appeals makes a ruling of law, whether on appeal of a final judgment or in an interlocutory appeal, that ruling becomes the law of the case in any subsequent proceedings in the trial court. *Elias* v. *Ford Motor Co.*, 734 F.2d 463 (1st Cir. 1984). Such a ruling is "[a] mandate [that] is completely controlling as to all matters before the appellate court and disposed of by its decree." *Id.* at 465.

We agree with Sylvania that the magistrate judge did not contradict our legal ruling in *Knapp* that the defense of limitation of remedies was waived and now out of the case. He did not rest any of his own legal rulings on the proposition that Knapp had limited its remedies by contract to credit for returned shoes; indeed, he awarded Knapp damages for defective shoes still in its possession (although he found the number of such shoes to be very small). To that extent, Knapp's law-of-the-case claim is something of a diversion.

At the same time, on an intermediate proposition of fact a direct conflict exists between our earlier opinion and the most recent decision of the magistrate judge. The magistrate judge repeats in the footnote to paragraph 49, quoted above in text, his earlier conclusion that Knapp and Sylvania did agree in fact to limit Knapp's remedies; and he recognizes that this court on the prior appeal "concluded otherwise." Our actual conclusion was slightly narrower — we said that the parties had not purported to litigate the issue and we could find no evidence of such an agreement — but the fact remains that

the magistrate judge has reasserted his view that such agreement has been proved.

All this might matter little if the magistrate judge's disagreement with us played no role in his decision, but he goes on to say that "this finding and conclusion bears heavily on the credibility of the witnesses called by Knapp, and other issues to be determined herein." No resort to law of the case doctrine is required for us to determine that his "finding and conclusion" that such an agreement existed limiting remedies is clearly erroneous. The very same defect — the lack of evidence to show such an agreement — identified in our earlier decision remains, utterly unaltered.

We explained in our earlier opinion why we were not persuaded of such an agreement by the magistrate judge's reliance on Esser's testimony that a return remedy existed — testimony that did not even purport to address the exclusivity of the remedy — and also why we saw no course of dealing by the parties that could prove such a limitation. 15 F.3d at 1226-27. No new evidence was taken on remand to prove this limitation; no additional support for it is mustered by the magistrage judge out of the pre-existing record.

About the best we can do in this disturbing situation is to defer to the usual extent as to those findings of the magistrate judge that we are confident have not been infected by his belief in the supposed agreement limiting remedies; and, on all other findings, to consider them in the knowledge that the magistrate judge has credited or discredited certain witnesses based (at least in part) on a premise that we have already held to be mistaken. Sorting out findings in this way, and deciding how to treat infected findings, is something of a task but better than an outright remand on all issues to a new judge.

THE MERITS

Our analysis of the merits is divided in three parts. Knapp raises some rather half-hearted objections to the magistrate judge's rulings that reject most of its counts; we find that these rulings are sustainable on this record. Knapp's next objections concern the magistrate judge's rulings on remedies; here we find that the magistrate judge's analysis of the remedies available to Knapp was correct on one issue (Knapp's purported revocation of acceptance of all shipments) but flawed on another (Knapp's rejection of the first February 1990 shipment). Finally, we find that elements of the magistrate judge's determinations on damages were clearly erroneous but that the necessary corrections can be made on the existing record.

A. *Liability*.

Knapp's complaint alleged eight causes of action. The magistrate judge ruled that Knapp had failed to persuade on all except for counts 3 and 4, breaches of implied warranties of merchantability and fitness; these warranties were held to be breached only with respect to those shoes that were actually defective. Sylvania does not appeal that limited finding of liability; Knapp appeals from the decision rejecting its other counts, but its arguments are without merit.

Breach of Contract. With respect to count 1, breach of contract, Knapp objects that the magistrate judge in rejecting this count relied upon his footnote 49 finding that the parties had previously agreed to limit remedies. But Knapp's own count 1 alleged only that Sylvania failed to deliver shoes of promised quality; and it has not shown how this claim exceeds the breach of warranty claims that the magistrate judge allowed under counts 3 and 4. We therefore affirm the magistrate judge's disposition of count 1.

Breach of Express Warranty. On count 2, the breach of express warranty, Knapp argues that Sylvania warranted that it would produce a defect-free shoe and that the high defect rate caused each entire shipment to be in breach of Sylvania's express warranty. Knapp points to two letters sent to Knapp by Sylvania in mid-1988, when sole bond problems were affecting shoes in the 2600 line. In the first, Elliot wrote, "We know the industrial consumer wants this product and it is up to us to give it to him or her without defect." In the second, Elliot wrote, "As always, we stand behind our product and fully warrant the product against manufacturing defect."

If Knapp means to suggest that Sylvania had warranted that each and every shoe in a given shipment would be free of defects and that a shipment could be rejected based on any such defect, that suggestion is not reasonable. At trial witnesses for both parties agreed that no one in the shoe industry expects that any shipment of shoes will be entirely free of defects. Sylvania's quoted statements can at most be read to mean that it was capable of producing shoes that met industry standards as to the percentage of defects.

Of course, to the extent that Sylvania breached its various commitments, it may as remedial measures be liable — under certain circumstances — to rejection of more than the particular shoes shown to be defective and to consequential damages that exceed the price paid for the particular defective shoes. *See* IV(B) and (C), below. But so far as Knapp's claim depends on the notion that Sylvania promised no defects at all, we think no such warranty was made.

Breach of Duty of Good Faith and Fair Dealing. Count 5 alleged that Sylvania breached its duty of good faith and fair dealing.[3] In his January 31, 1991, memorandum, the magistrate

[3] In Massachusetts, "[e]very contract implies good faith and fair dealing between the parties to it." *Warner Ins. Co.* v. *Commissioner of Ins.*, 548 N.E.2d 188, 193 n.9

judge found that Knapp had failed to carry its burden on this claim, ruling that "the defendant acted in the utmost good faith in an attempt to correct a problem not reasonably foreseen by any of the parties to the relationship." Knapp insists that Sylvania's failure to correct its manufacturing processes, despite its assurance to Knapp that the quality of its shoes would improve, breached its duty.

Whether conduct violates the duty of good faith and fair dealing is necessarily a fact-specific inquiry, *see* E. Allan Farnsworth, *Contracts* § 7.17 (2d ed. 1990), and the magistrate judge's finding here is not clearly erroneous. There was ample untainted record evidence that Sylvania strove to improve the quality of the shoes it delivered; it changed its cement suppliers and implemented various design changes suggested by Knapp. There is no evidence that Sylvania's failure to improve its manufacturing process was motivated by bad faith rather than by a simple failure to root out and remedy all of the problems.

Fraud and Negligent Misrepresentation. Counts 6 and 7 charged fraudulent and negligent misrepresentation, claims that in Massachusetts require a false representation of a material fact, knowledge of falsity or carelessness on the part of the defendant, and reasonable reliance by the plaintiff.[4]

The magistrate judge found, in his memorandum of January 31, 1991, that Knapp's misrepresentation claims failed because Sylvania had done what it said it would do — use its best efforts to produce shoes free of defects. On appeal, Knapp insists that Sylvania had repeatedly and falsely assured Knapp that it would correct any problems with the shoes, and that

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(Mass. 1990) (quoting *Kerrigan* v. *Boston*, 278 N.E.2d 387, 393 (Mass. 1972). Similarly, Mass. Gen. L. c. 106 ("UCC") § 1-203 imposes an "obligation of good faith."

[4] *VMark Software, Inc.* v. *EMC Corp.*, 642 N.E.2d 587, 593 n.8 (Mass. App. Ct. 1994); *Zimmerman* v. *Kent*, 575 N.E.2d 70, 77 (Mass. App. Ct. 1991).

Knapp reasonably relied on these representations in continuing its purchases.

We need not decide whether such reliance would be reasonable, *but cf.* IV(C) below, because we agree that no false representation has been shown. The evidence at trial indicated that Knapp and Sylvania remained in regular contact regarding proposed design and manufacturing changes, and Sylvania never misrepresented the changes it proposed to carry out. In this context, Sylvania's conclusory statements that its quality would improve — and Knapp calls our attention to no more specific alleged misstatement — are no more than an "expectation, estimate, opinion, or judgment." *See Powell* v. *Rasmussen*, 243 N.E.2d 167, 168 (Mass. 1969).

Chapter 93A. On count 8 — Knapp's c. 93A claim — we again affirm the magistrate judge. For Knapp to prevail, it must prove that Sylvania's conduct included an "unfair or deceptive act," a phrase that the Massachusetts courts read as requiring a showing of "rascality;" the showing is especially difficult where the case involves arm's-length transactions between sophisticated business entities. *Anthony's Pier Four, Inc.* v. *HBC Assocs.*, 583 N.E.2d 806, 821 (Mass. 1991).

The crux of Knapp's argument is that Sylvania was aware that there were problems with its manufacturing process and failed to make the needed changes. But as the magistrate judge held, there was no evidence at trial that Sylvania's failure to improve the quality of its shoes was deliberate or willful; on the contrary, it made repeated efforts on its own and in consultation with Knapp to correct perceived problems. Knapp's claim for multiple damages and attorney's fees was therefore properly denied.

B. *Revocation and Rejection Remedies.*

Even if liability is based only on counts 3 and 4, Knapp argues on appeal that the magistrate judge nevertheless erred in determining the remedies available to it. It says that he improperly denied to Knapp remedies of "revocation of acceptance" (with respect to all prior shipments) and "rejection" (with respect to the shipment of February 1990) and that these errors led him into a further error, namely, to direct his damage assessment only to those shoes actually shown to be defective.

Revocation of Acceptance as to All Shoes. Knapp first argues that it is entitled to revoke acceptance of all inventory purchased from Sylvania — including non-defective shoes — because the rate of defects was so high as to make it impossible for Knapp to sell shoes from that inventory. The magistrate judge rejected this remedy because he found a very low rate of defects. Although this finding is not adequately supported, *see* IV(C) below, we agree with the result because Knapp failed to make an effective revocation of its acceptance under UCC § 2-608.

When a buyer "accepts" goods, as defined in UCC § 2-206, the buyer forfeits the right to "reject" the tender. UCC § 2-607. However, a buyer may be able to "revoke acceptance" under UCC § 2-608 as follows:

> (1) The buyer may revoke his acceptance of a lot or commercial unit whose non-conformity substantially impairs its value to him if he has accepted it
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> (a) on the reasonable assumption that its non-conformity would be cured and it has not been seasonably cured; or
>
> (b) without discovery of such non-conformity if his acceptance was reasonably induced either by the

> difficulty of discovery before acceptance or by the seller's assurances.
>
> (2) Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. It is not effective until the buyer notifies the seller of it.

The buyer who revokes has the same rights and duties as if the buyer had rejected the goods. UCC § 2-608.

Knapp argues that this case falls squarely within section 2-608(1)(b). It says that the sole-bond problems were hard to discover because they could not be detected by visible inspection and that it reasonably relied upon Sylvania's assurances that it had corrected the bond problem. Knapp cites to *S & R Metals, Inc.* v. *C. Itoh & Co. (America)*, 859 F.2d 814 (9th Cir. 1988), as authority for the view that a buyer can revoke acceptance when the prior acceptance was made without knowledge of the defect and the defect was "latent and difficult to discover."

The difficulty with Knapp's position is that by mid-1988 it had ample knowledge that customers were complaining about separation, and its own experience confirmed that Sylvania was not successfully solving the underlying problems. Knapp itself points to pull-tests done in 1988 which, it argues, prove that Sylvania's manufacturing process was flawed. Yet not until spring 1990 — the precise date is disputed — did Knapp purport to revoke acceptance for all shoes delivered to it over the entire period.

This is not a revocation occuring within "a reasonable time" after the buyer discovered the ground for rejection, and the contrast between the present facts and those of *S & R Metals*

underscores the point. In that case, the buyer had no reason to doubt the quality of the steel until complaints were received; advance testing would have been expensive and destroyed the valuable product tested; and the revocation of acceptance was made within *nine days* after the defect had been discovered and confirmed. *S & R Metals*, 859 F.2d at 817. Nothing in this decision, or any other cited by Knapp,[5] suggests that a buyer can accept deliveries of a vast number of items over a period of a year and a half and then suddenly revoke the acceptance of all of them based on defects whose presence was known or suspected during the entire period.

Rejection of the February 1990 Shipment. A much narrower and stronger claim by Knapp is that it properly rejected the single shipment of shoes received in February 1990. Section 2-601 of the UCC provides that if goods or tender fail to "conform" to the parties' contract, the buyer may reject the whole delivery;[6] but this rejection must be within a reasonable time, and the buyer must seasonably notify the seller of the rejection. UCC § 2-602(1). The magistrate judge found that Knapp failed to prove that the February shipment was nonconforming, and further found that Knapp's rejection was untimely.

Knapp insists that the shipment was nonconforming because all of the shoes in the shipment were defective inasmuch as

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[5] In *Fortin* v. *Ox Bow Marina, Inc.*, 557 N.E.2d 1157 (Mass. 1977), also cited by Knapp, the court allowed the buyer to revoke acceptance of a boat delivered four months earlier when the seller had provided repeated assurances that it would cure the identified defects in the boat. The case involved a different problem — a promise to repair a specific item already delivered — and is governed by a different provision (section 2-608(1)(a)).

[6] To permit rejection of the entire shipment for nonconformity, Knapp had to show not just that there were defective shoes but that the defect rate was higher than agreed upon or, lacking specific agreement, than the standard in the industry. *See Agoos Kid. Co.* v. *Blumenthal Import Corp.*, 184 N.E. 279, 281 (Mass. 1932).

they could be pulled apart manually. Crabtree, Knapp's key witness on this issue, so testified at trial. The magistrate judge made clear that he did not accept Crabtree's testimony, but this appraisal may well have been affected by the magistrate judge's mistaken finding on limitation of remedies: Crabtree also testified to the fact that the procedure of return of customer defects was established only in mid-1988 and that before that time customer returns were discarded, a fact that the magistrate judge found surprising in view of the "clear understanding between the parties."

Knapp did carry out a prompt inspection of the shoes that arrived in the February 1990 shipment, complained immediately to Pearlstein that the shoes were 100 percent defective, and sent him a case for his own inspection. When the formal "rejection" occurred is disputed — the magistrate judge found that it did not occur until May — but Knapp's actions were certainly consistent with its claim of substantial defects and represented steps toward rejection. It immediately placed the seller on notice that the defects were pervasive and began to negotiate the seller's response.

The magistrate judge chose to credit fully the testimony of Pearlstein, Sylvania's president, to the effect that no shoes from the sample case sent by Knapp to Sylvania from the February shipment separated. But quite apart from other Knapp witnesses who supported Crabtree, other *Sylvania* employees — Elliot and Cartwright — both agreed that at least some of the shoes could be pulled apart by hand. Thus, we find it hard to accept the magistrate judge's finding that "plaintiff has failed to establish by a preponderance of the evidence that any of the shoes — much less the whole of the lot — failed to conform."[7]

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[7]The magistrate judge suggested that the "hand" pull test is not standard in the industry and that evidence that shoes could be pulled apart by hand did not necessarily prove them defective. Common sense, buttressed by ample evidence at trial, confirms that an industrial work shoe is defective where it can readily be pulled apart by hand.

This court finds clear error only where, "on the whole of the record, we form a strong unyielding belief that a mistake has been made." *Cumpiano* v. *Banco Santander P.R.*, 902 F.2d 148, 152 (1st Cir. 1990) (citations omitted). In this instance, we conclude that the magistrate judge was clearly in error in finding that the February 1990 shipment was free of defects and conformed to industry standard. The question whether Knapp gave prompt notice is more difficult, but we need not resolve the issue because whether Knapp rightfully rejected the nonconforming shipment has no practical impact on the damages to which it is entitled. With the magistrate judge's finding on defects set to one side, Knapp's ordinary damages as to the February shipment produce essentially the same amount as it would receive under the "rejection" remedy. *See* IV(C) below.

C. *Damages.*

Knapp's damage claims were based upon its allegation that Sylvania shoes suffered from a very substantial rate of defects. In his final damages calculation, the magistrate judge found that the rate of defects in the inventory shoes involved in this litigation was less than four percent. Knapp argues on appeal that the magistrate judge's defect-rate finding was clearly erroneous, and insists that the evidence established a defect rate of at least 40 percent for the shoes remaining in inventory at Knapp. We think that the magistrate judge's finding is clearly erroneous and that on this record the 40 percent figure is the only alternative choice.

Knapp's allegations of substantial defect rates in the shoes remaining in inventory were supported by the detailed testimony by Crabtree; by corroborating testimony of other Knapp personnel; by evidence of substantial customer returns, dissatisfaction and cancelled relationships to which the customers

testified; by testimony that the number of defective shoes held by Knapp plus the number of prior returns acknowledged by Sylvania was nearly twice the magistrate's 3-to-4 percent finding; by evidence that both Knapp and customers threw away additional defective shoes; and, finally, by a fairly detailed sampling study that appeared to establish a defect rate of at least 41.7 percent.[8]

In adopting the 3-to-4 percent defect rate figure, the magistrate judge accepted the testimony of Esser and Sprague (both disaffected former Knapp employees) and of Sylvania personnel, to the effect that there was never a substantial problem with Sylvania shoes. He disregarded Crabtree as a liar; and he dismissed customer testimony as not necessarily relating to Sylvania shoes but rather to shoes manufactured in Taiwan. He found the pull tests inconclusive, insisting that Knapp had failed to present evidence that a pull-test failure at under 20 pounds showed that a shoe was defective. He refused to believe Knapp's accounting of the number of defective shoes in inventory.

Under the *Cumpiano* standard, we reject as clearly erroneous the magistrate judge's assessment of the percentage of defects in the Sylvania shoes. We have already explained why his related appraisal of testimony regarding quality of the February 1990 shipment is unpersuasive, *see* IV(B), and this is equally so on the broader question of the remaining inventory. Knapp's claims of defects came not only from Knapp but from customers disinterested in the litigation, from the presence in inventory of defective shoes actually returned to Knapp, and from the

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[8] A biostatistician analyzed the results of pull-tests performed on randomly selected pairs of unused shoes in inventory. Using a 20-pound figure for the pull-tests, 60 percent of the shoes failed. Given the sample size tested and the number of shoes in inventory, the expert concluded that "we have a 95 percent level of confidence that the actual proportion of defective pairs in the inventory . . . is at least 41.7 percent."

pull-tests conducted by independent experts — the last of which samples the entire remaining Knapp inventory in the contested models.

The notion that *any* of these defective shoes came from foreign sources rests on doubtful evidence; but, given the poor quality of the February 1990 shipment admittedly from Sylvania, it is obvious that foreign sources do not explain away the problem. From the testimony on pull-tests, it appears that the 20-pound figure that Knapp asked the expert to employ was not only plausible but conservative. Knapp's accounting of the number of defective shoes in its inventory was essentially uncontradicted. In sum, the evidence is overwhelming that the defect rate was considerably higher than the rate adopted by the magistrate judge.

Each side had its chance to present evidence and neither side is entitled to introduce further evidence on this issue. On the present record the stark choice is between Sylvania's claim that defects were no greather than normal and Knapp's evidence to the contrary. The Knapp evidence was that it had 6,045 known defective pairs in inventory, comprising shoes returned by customers, the 1,422 pairs torn-apart from the February 1990 shipment and other shoes pulled apart during inspection of inventory, and — in addition — that it had in inventory 21,010 new shoes of the models involved in this litigation, at least 41.7 percent of which the statistical sampling showed to be defective.

The evidence as to raw numbers in inventory was essentially uncontradicted even though the magistrate judge declined to accept the numbers. As for the statistical study, the 20-pound pull-test was (as already noted) a conservative standard based on the evidence; and the 41.7 percent figure even more so. Sylvania has chosen not to contest its liability for defective shoes no matter how long in inventory. "Where, as here, the

record is sufficiently developed that we can apply the law to the facts before us . . . that route is available to us." *Lipsett* v. *Blanco*, 975 F.2d 934, 943 (1st Cir. 1992). We take it here and find that Knapp has proved the raw figures and defect rate just discussed, any other conclusion on this record being clearly erroneous.

As for the cost of the shoes, we agree with the magistrate judge that the most accurate figure is the average price of the shoes purchased by Knapp, rather than Knapp's "Fifo average cost."[9] Using the magistrate judge's price figures for each model and applying that price to the larger number of defective shoes that we have found to be present in Knapp's inventory (14,806), we have calculated Knapp's damages for defective shoes as $338,138.31. The calculations, by model number, are set forth in Appendix A.

Knapp argues that regardless of the precise percentage of defective shoes in its inventory, all of the shoes are useless to it because the number of defects is too high to allow Knapp to deliver the shoes to customers without fear that they will fall apart on their feet. Knapp is essentially attempting to invoke through the back door the revocation of acceptance remedy that Knapp failed to invoke in a timely manner. Whatever decrease Knapp has suffered in value of the non-defective shoes, Knapp inflicted this decrease on itself when it accepted the deliveries and failed to revoke that acceptance within a reasonable time.

Knapp also claimed a detailed list of incidental damages, some of which were granted by the magistrate judge and are not challenged by Sylvania on appeal. Knapp insists that it is

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[9] Even if we were to accept (as the magistrate judge did not) that Knapp maintained a strict Fifo inventory procedure, some of the new shoes in Knapp's Brockton warehouse were returned from field warehouses; some may have been from early shipments, and the average price figure therefore appears to us to be the better measure.

also entitled to reimbursement for a credit it issued to Federal Express and for storage costs beyond those granted by the magistrate judge. The magistrate judge found that Knapp had failed to prove that it had not received credit from Sylvania or replacements for the defective shoes for which Federal Express demanded and received credit.

We agree that Knapp failed to prove that this credit represented actual damages.[10] As to the storage charges, Knapp will be credited only for the amount attributable to the actually defective shoes, as the magistrate judge held, but that amount is increased to $4,146 to account for the enlarged number of defective shoes determined on this appeal. The result is achieved by using the magistrate judge's own formula set forth in his March 1, 1995, decision.

Knapp further claims that it is entitled to lost profits from the shoes in inventory it could not sell. To recover lost profits, the plaintiff must show by a preponderance of the evidence that the actionable breach caused the loss and that the loss was foreseeable and calculable with reasonable certainty. *Matsushita Electric Corp.* v. *Sonus Corp.*, 284 N.E.2d 880, 890 (Mass. 1972). For the pre-February 1990 shipments, Knapp's claim is hopeless. Knapp did not show that it had an urgent need for any of that inventory, nor justify its failure to obtain alternative sources given its knowledge of persisting problems. *See* UCC § 2-715(2)(a) (consequential damages include only those losses "which could not reasonably be prevented by cover or otherwise").

With respect to the February 1990 shipment, the issue is closer, because Knapp established at trial that it had an urgent

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[10] It is apparently undisputed that Knapp gave credit to its customer Federal Express to resolve complaints about defective shoes. Nevertheless, the evidence left it uncertain whether some of the shoes reflected in this figure had already been returned by Knapp to Sylvania or were among shoes in Knapp's inventory, damages for which are already reflected in the calculations in Appendix A. The burden was on Knapp to show actual damages without double counting, and it failed to do so.

need for that inventory; the quality of that shipment was even lower than earlier shipments; and Sebastiao testified that Knapp lost orders because it could not deliver these shoes. On the other hand, Knapp was on notice that Sylvania shoes suffered from a high rate of defects, so its failure to switch to other, more reliable suppliers at an earlier date is hard to justify. Knapp knew or should have known that it might well get defective shoes in the February shipment, and it chose to take the risk. We affirm the magistrate judge's finding that lost profits are not appropriately awarded.

Knapp also presses on appeal its broader claim for consequential damages. It presented at trial expert testimony that because of the defective shoes Knapp lost future profits of $2,895,326 that it would have enjoyed on *other* sales to customers who left Knapp out of dissatisfaction with its product. Its evidence certainly showed that its relationships with important customers were irretrievably damaged. But it is equally clear that Knapp could have minimized the damages through reasonable diligence by increasing its inspections and, to the extent needed, finding alternative suppliers.

Although Sylvania was at fault for supplying defective goods and must reimburse Knapp for those goods proved to be defective, Knapp cannot recover for any larger harm done to its own reputation and customer relations. The general principle is well settled that a party cannot recover for harms that its own reasonable precautions would have avoided. *Columbia Novelty Co.* v. *Leslie Dawn, Inc.*, 6 U.C.C. Rep. Serv. (Callaghan) 679, 679 (N.Y. App. Term 1969); UCC § 2-715(2)(a). To permit such a recovery on this record would simply reward Knapp for its own lack of attention, poor quality control, and bad judgment.

CONCLUSION

In summary, Knapp is entitled to damages as follows:

Cost of Defective Inventory:	$338,138.31
Storage Costs:	$4,146.00
Unpaid Credits:	$92,472.97
Credit to Miami Hilton:	$9,250.00
Refund to Marriott:	$3,194.54
Price concessions to Federal Express:	$11,096.25
Replacement shoes supplied to Hilton:	$6,401.20
Increased inspection costs:	$4,167.30
Freight charges:	$6,877.60
Travel expenses:	$1,793.92
Total	$477,538.09

The first two entries are adjusted to reflect the corrections explained in the opinion; the others are as determined by the magistrate judge in rulings that Sylvania has not appealed. The award against Knapp in favor of Sylvania for unpaid bills, in the amount of $223,626.47, has also not been challenged on appeal and so stands as previously entered.

On remand, the judgment should be modified to award $477,538.09 to Knapp and $233,626.47 to Sylvania, so that the net award is now in Knapp's favor in the amount of $243,911.62.

It is so ordered.

Style	Defects	New	x41.7%	Total	Avg. Cost	Cost
1244	150	199	83	233	18.20	4,240.60
1245	63	189	79	142	23.75	3,372.50
1251	493	509	212	705	21.65	15,263.25
1257	111	402	168	279	26.25	7,323.75
2600	914	765	319	1.233	24.25	29,900.25
2601	47	60	25	72	25.75	1,854.00
2605	578	2,034	848	1,426	26.75	38,145.50
2660	485	1,926	803	1,288	23.25	29,946.00
2665	654	955	398	1,052	22.00	23,144.00
2670	464	599	250	714	27.90	19,920.60
2675	566	404	168	734	27.90	20,478.60
2810	514	2,438	1,017	1,531	21.91	33,544.21
2814	53	1,474	615	668	18.75	12,525.00
2815	51	1.311	547	598	22.10	13,215.80
2816	26	87	36	62	22.10	1,370.20
2840	125	548	229	354	27.40	9,699.60
2845	136	1,538	641	777	27.30	21,212.10
2916	39	264	110	149	18.75	2,793.75
2930	339	3,968	1,655	1,994	17.25	34,396.50
2935	211	1,302	543	754	19.90	15,004.60
2950	1	38	116	17	18.75	318.75
2955	25	0	25	25	18.75	468.75
Total	6,045	21,010	8,761	14,806		338,138.31

The first column refers to the Knapp shoe style number; the second column sets out the number of customer's returns plus shoes pulled apart by Knapp personnel in Knapp's inventory; the third column sets out the number of new shoes in inventory; the fourth column gives the number of defective shoes among the new shoes, based on the statistical survey; the fifth column gives the total number of defective shoes in Knapp's inventory; the sixth column gives the average price for each style; the last column gives the price paid by Knapp for defective shoes still in inventory.

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 95-1220

KNAPP SHOES, INC.,
PLAINTIFF-APPELLANT,

v.

SYLVANIA SHOE MANUFACTURING CORPORATION,
DEFENDANT-APPELLEE.

ERRATA SHEET

The opinion of this court, issued on December 20, 1995, is amended as follows:

On page 36, line four, replace $233,626.47" with $223,626.47".

On page 36, line five, replace $243,911.62" with $253,911.62".

On page 36, line five, add to the end of the paragraph the following sentence: "In addition, the magistrate judge's order terminating the injunction against Sylvania, as entered on May 31, 1991 and amended on June 10, 1991, is vacated; the magistrate judge is free to reduce the amount embargoed to the net award plus anticipated costs and interest."

[Entered: January 12, 1996]

APPENDIX B

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

Civil Action No.

90-10916-Y

KNAPP SHOES, INC.,
PLAINTIFF,

v.

SYLVANIA SHOE MANUFACTURING CORPORATION,
DEFENDANT.

MEMORANDUM OF FINDINGS AND CONCLUSIONS

March 1, 1995

COHEN, M.J.

This case was tried to this court without a jury with the consent of the parties pursuant to the provisions of 28 U.S.C. § 636(c) and Rule 4(c) of the Rules for United States Magistrates in the United States District Court for the District of Massachusetts.[1]

In the original complaint (# 01),[2] plaintiff, Knapp Shoes Inc. ("Knapp"), alleged breach of contract (Count 1), Breach of Express Warranties (Count 2), Breach of Implied Warranties

[1] Prior to trial, this court ordered bifurcation of the liability phase from the damage phase.

[2] Knapp was subsequently granted leave to file an amended complaint. That amended complaint (# 73), however, only added claims in the nature of injunction (Count 10) and trustee process (Count 11). The claimed bases for relief remained the same.

(Count 3), Breach of Warranty of Fitness (Count 4), Breach of Duty of Good Faith and Fair Dealing (Count 5), Common Law Fraud (Count 6), Common Law Negligent Misrepresentation (Count 7), Unfair and Deceptive Practices within the Meaning of Mass. Gen. Laws, Chapter 93A, § 11 (Count 8), and Declaratory Relief (Count 9).

Based on these claims, Knapp sought compensatory damages, including consequential damages, and, of course, the customary double and treble damages, as well as attorneys' fees, under Chapter 93A.[3]

Defendant, Sylvania Shoe Manufacturing Corporation ("Sylvania"), denied plaintiff's claims, and counterclaimed for some $223,626, more or less, based on claims of breach of contract (Counts 1 and 3), Unjust Enrichment (Count 2), and unfair and deceptive practices within the meaning of Chapter 93A, § 11 (Count 4).

I. *FINDINGS OF FACT*

This dispute — not unlike many — was the result of a relatively new idea. Knapp sought to infuse the market with

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[3] After trial on the liability phase concluded, this court, on January 31, 1991, entered a Memorandum and Order (# 55), concluding that plaintiff had failed to establish by a preponderance of the evidence that defendant had violated *express* warranties (Count 2), or that defendant had breached its duty of good faith and fair dealing (Count 5), or that defendant had committed common law fraud (Count 6), or common law negligent misrepresentation (Count 7), or that defendant had engaged in unfair and deceptive practices of the sort warranting double or treble damages under the provisions of Chapter 93A. Those matters and rulings shall not be revisited by this court, and judgment shall enter accordingly with respect thereto.

Therefore, this Memorandum of Findings and Conclusions only addresses Knapp's remaining claim, *i.e.*, breach of contract (Count 1), breach of implied warranty of merchantability (Count 3), breach of warranty of fitness (Count 4), and Chapter 93A (Count 8), to the extent that that claim hinged upon a breach of warranty and the definition given to unfair and deceptive practices by the Attorney General for the Commonwealth of Massachusetts (940 C.M.R. 3.00 *et seq.*), pursuant to the provisions of Chapter 93A, § 2(c).

a new concept, to wit: work and protective shoes which, if not quite fitting the Air Jordan image, nevertheless were more or less casual. In a nutshell, plaintiff contends that defendant failed to live up to its bargain of manufacturing a conforming shoe. Because of this, plaintiff contends, plaintiff was entitled to terminate the agreement, revoke acceptance of shoes previously received and accepted from defendant pursuant to the agreement, reject acceptance of shoes shipped in February 1990, and repudiate shoes manufactured but not yet in the possession of the plaintiff, under the provisions of §§ 2-601, 2-608 and 2-609[4] of the Uniform Commercial Code (M.G.L. c. 106, §§ 2-601, 2-608, 2-609).[5] Based on the testimony and exhibits presented, and assessment of the credibility and reliability of that testimony and those exhibits, this court makes the following findings of fact.

1. Knapp, a Massachusetts footwear manufacturer, sells and distributes shoes. In addition to selling and distributing shoes which Knapp itself manufactures, Knapp also sells and distributes shoes manufactured by other shoe companies under the Knapp logo.

2. Sylvania, a Pennsylvania footwear manufacturer, is one such company. Sylvania does not manufacture shoes to be sold

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[4] As this court understands the contentions of plaintiff, § 608 (revocation of acceptance) relates to shoes shipped and received by defendant prior to February 1990, § 601 (rejection) relates to a shipment of shoes made and received in February 1990, and § 609 (repudiation) relates to shoes manufactured by Sylvania but not yet shipped.

[5] The parties have addressed the issues raised by the pleadings as issues governed by Massachusetts law. Given that the arrangement between the parties contemplated delivery of goods to Massachusetts at the behest of a Massachusetts customer [plaintiff], it appears that Massachusetts law does control. In any event, as observed by the United States Court of Appeals for this Circuit —

> Where the parties agree what substantive law controls in a diversity case, we can — and ordinarily should — accept such a concession.

Moores v. *Greenberg*, 834 F.2d 1105, 1107 n.2 (1st Cir. 1987); *see also Kali Seafood, Inc.* v. *How Corporation*, 887 F.2d 7 (1st Cir. 1989).

under its own name. Instead, Sylvania manufactures shoes to be sold and distributed under other shoe companies' names, in this case, Knapp.

A. *A Basic Understanding of Shoe Construction*

3. The basic construction of the shoes Sylvania manufactured for Knapp consisted of a leather "upper" — that part of the shoe above the midsole, and a patented slip-resistant rubber outsole.

4. For the most part, all aspects of shoe manufacture are done manually. The most pivotal aspect in the construction of a shoe is the adhesion bond between the midsole and the leather upper. In order to ensure this critical bond, preparation of the surfaces on both the leather upper and EVA midsole is crucial. The EVA must first be roughed to remove oxidation and other contaminants on its surface. After roughing, the EVA midsole is bonded, via a type of adhesive cement, to the outsole. The EVA midsole and the outsole are then trimmed to the specific shape of the shoe.

5. This trimming process generates dirt and other contaminates and therefore the top of the EVA midsole should be cleaned or air blown prior to cementing it to the leather upper which also must be properly prepared.

6. In preparing the upper, the leather must be specifically cut to the exact size of the shoe. If the cut is too large, "pleating" occurs. If the pattern is cut too small, the leather will rupture when the shoe is placed on the last.[6]

7. After the leather upper is suitably lasted, it too must also be properly roughed. After roughing occurs, a layer of cement

[6] A last is a hard piece of plastic that models as a "foot" around which the leather is wrapped to form the shape of the shoe.

is applied to the leather upper. The cement is absorbed into the leather and left to dry. It is imperative during this drying time that the upper not be contaminated by dust, dirt or various other pollutants.

8. The leather upper and midsole are then bonded together. Since — at this time — the cement on both surfaces has dried, it must be properly "activated." Activation occurs by exposing both surfaces to heat, approximately 125 degrees to 130 degrees Fahrenheit for about fifteen seconds depending upon the shoe.

9. Upon activation of the cement, the midsole and upper are pressed together before the cement has any opportunity to cool.

B. *The Manufacture of Shoe Style 1249, 1250, 1251*

10. In December of 1986, Jack Esser ("Esser"), Knapp's Senior Vice President for Merchandising & Manufacturing, authorized Knapp personnel to contact Sylvania and inquire whether Sylvania would produce, on an expedited basis, a black shoe Knapp was selling to the Postal Service.[7] Knapp had previously purchased this style shoe overseas; however, new governmental regulations required that the shoes be manufactured in the United States.

11. On December 23, 1986, Knapp ordered over ten thousand pairs of the postal shoes from Sylvania. These shoes, style numbered 1249 and 1250 were delivered in January and February, 1987. The shoes were found to be to Knapp's satisfaction. (Esser, 5-24).

12. Styles 1249 and 1250 were shoes with leather uppers cemented to a polyurethane sole. The manufacture of style 1249

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[7] Since these style shoes were primarily marketed to the Postal Service, these styles are collectively referred to herein as the postal shoes.

and 1250 were standard construction in the footwear industry. (Esser, 5-20).

13. Subsequently, in approximately March or April of 1987, Esser contacted Colin Elliot ("Elliot"), Vice President of Sylvania. Esser and Elliot agreed that Sylvania would manufacture for Knapp an athletic style slip-resistant shoe. This shoe was style numbered 1251.

14. Style 1251 was a lightweight "sneaker" type version of the postal shoe.

15. The midsole in style 1251 was constructed with a lightweight synthetic rubber material known as ethyl vinyl acetate ("EVA"). In March or April of 1987, the utilization of EVA as a midsole was standard within the shoe industry.

16. In the summer of 1988, Knapp reported numerous calls regarding sole separation on style 1251. (Ex. 46). Since style 1251 was a black shoe, the flaw could not be attributed to the white pigment in the cement.[8]

17. In August of 1988, Sylvania, due to the continued complaints of sole separation, switched from purchasing its cement from Imperial Adhesives, to Mid-West Industrial Chemical Company. Additionally, Sylvania informed Knapp that Sylvania was adding an extra layer of cement on all shoes manufactured with the old cement. Furthermore, Sylvania indicated that it would "lip" cement all non-steel toe shoes in order to provide a "wrapping" on the midsole to the upper.

18. Knapp continued to order style 1251. (Esser, 5-21, 22, 24). From 1987 through 1989, Knapp received 40,369 pairs of Style 1249, 1250, and 1251 from Sylvania. (Ex. J & L).

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[8] The first indications of sole separations occurred in a white, women's athletic steel toe style 2665. The sole separation was rectified, there being a problem with too much white pigment in the cement.

C. *Manufacture of Steel Toe Shoe Styles 2600, 2601, 2605*

19. During this period in which Sylvania was successfully manufacturing the postal shoes, Esser again approached Elliot of Sylvania, to determine if Sylvania would manufacture a steel toe version of style 1251. (Esser, 5-34).

20. Since Sylvania had never manufactured a steel-toe shoe, and had neither the machinery nor equipment, Esser assured Elliot, "We'll show you or assist you in any technical problems you might have to get started. And we'll even ship you our equipment and so forth." (Esser, 5-34).

21. Sylvania agreed to manufacture a version of the postal shoe with a steel toe which was designated style number 2600.

22. Knapp provided a prototype of the shoe it desired Sylvania to manufacture. (Esser, 5-37).

23. Knapp's proposed construction of the shoe was new in the industry. While EVA midsoles and toe bumpers were standard fare for jogging type shoes, both Knapp and Sylvania knew that there were risks in utilizing an EVA midsole for a more industrial type, steel-toe shoe. While the EVA would make the shoe lighter and more comfortable, there could be sole adhesion problems in an industrial setting, since EVA can be attacked by oil-based products commonly found in industrial settings. (Esser, 5-41).

24. Esser, prior to authorizing production of the steel toe shoes, inspected the manufacturing operation at Sylvania. Esser also inspected the results of prototype shoes manufactured by Sylvania. Esser directed Sylvania to make change in the engineering as the prototype was developed. Esser gave approval to the overall appearance and fit of the shoes. (Esser, 5-42, 45).

25. On July 17, 1987 and August 7, 1987, Knapp received the steel toe version of the postal shoe style 2600 (black), 2605 (white), and 2601 (grey). Each style was constructed with a strip of rubber on the front called a "toe bumper."

26. Upon inspection, Knapp determined that the bond between the toe bumper and upper was weak due to improper roughing by Sylvania.

27. Knapp returned thousands of these shoes to Sylvania for repair. (Esser, 5-70).

28. Sylvania fully corrected and/or replaced these returned shoes before a single pair went out to any of Knapp's customers. The pigment in the cement on shoes manufactured at the end of 1987 caused the toe bumper, sole adhesion problems.

29. Esser and John Sprague, the latter also of Knapp, testified they were "satisfied" with Sylvania's response to the pigment problem. (Esser, 5-74, -75; Sprague; 8-12).

30. Esser determined that the 2600 line was a "very strong selling line" and Knapp reordered style 2600 in 1987, and again in 1988, and yet again in 1989.

31. Knapp continued to order the style 2600 series despite the fact that in August of 1988 Knapp received reports from its retail locations that there were some sole separation problems with the style 2600 line.[9] (Esser, 5-75).

32. Knapp, although it was aware of the uncertain nature of the slip-resistant design, nonetheless aggressively marketed the slip-resistant shoe to the service industry beginning in 1987, stressing the slip-resistant features of the shoes. (Duggan, 12-5).

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[9]The 2600 series consisted of styles 2600, 2601, 2605, 2660, 2665, 2670 and 2675.

33. The 2600 series was Knapp's largest sale volume shoe. It was the shoe Knapp sold to its largest customer, Federal Express. Federal Express reported to Knapp that it had defective shoes across the country and demanded $125,000 credit for the shoes. (Ex. 8).

34. From July of 1987 through December of 1989, Sylvania delivered to Knapp 144,145 pairs of shoes in the 2600 style. (Ex. J & L).

D. *Manufacture of Non-Steel-Toe Slip-Resistant Style 2810, 2930*

35. In 1987, while Sylvania was manufacturing the style 2600 steel toe shoes, Sylvania also agreed to manufacture for Knapp, at the latter's request, a line of non-steel-toe slip-resistant industrial shoes. These shoes had the same patented sole as the steel-toe shoe with an EVA midsole construction but did not have a steel toe. These shoes were styled 2810 and 2930.[10]

36. These non-steel-toe slip-resistant industrial shoes were primarily manufactured for use in the hotel and restaurant field. Hotels and restaurants were interested in these shoes because they minimized accidents, thereby lessening insurance premiums.

37. Some of the larger hotels and restaurants which purchased these slip-resistant shoes from Knapp included the Hilton Hotel Corporation (which ordered style 2810 for men and style 2930 for women); the Atlanta Family Restaurant, a franchiser of forty-three Shoney's in the Atlanta area; the Spartan Food

[10] Originally, Knapp had contracted for the manufacture of the 2810 and 2930 styled shoes with a Taiwanese manufacturer named SanShoe. (Esser, 5-53).

Esser was facing "exasperat[ing]" (Esser, 5-53) problems with the quality of the SanShoe manfactured shoes. Knapp received approximately 2,400 SanShoe shoes, and was awaiting delivery of another 24,000 pairs when Knapp and Sylvania agreed that Sylvania would manufacture these shoes. (Esser, 5-56).

Systems/TW Services, Inc., franchising several national restaurant chains, including Hardee's and Quincy's; and the Marriott Corporation.

38. Knapp asked Sylvania to "copy [the SanShoe model] as closely as they could make the shoe" and utilize the same style numbers. (Esser, 5-55).

39. Even though Sylvania began manufacture of the 2810 and 2830 style shoes, Knapp did not cancel its orders with SanShoe. The SanShoe models were placed in the same storage bins in Knapp's warehouse as were the Sylvania. (Esser, 5-58, 59). When Knapp fulfilled customer orders for either the 2810 or the 2930 style shoes, the customer could receive either the Sylvania or the SanShoe manufactured version. Sometimes a single shipment to one customer would contain shoes manufactured by both Sylvania and SanShoe. (Esser, 5-59; Taylor, 15-59). Returns of the Sylvania and the SanShoe shoes were mixed together [11]

40. James Taylor ("Taylor") was Knapp's Regional Sales Manager for the Southeast from 1984-1991. Taylor, a Knapp

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[11] To the extent Esser's testimony contradicts that of Crabtree's on this and other matters, this court finds more credible the testimony of Esser. One such example of a contradiction is when Esser testified there was no first-in/first-out ("FIFO") system for the inventory and that both the SanShoe and the Sylvania shoes with the exact same style numbers were stocked, mixed amongst themselves. Crabtree testified that Knapp had a FIFO system of inventory at its Brockton warehouse. (Crabtree, 15-1122). Additionally, if Knapp did have a FIFO system, Knapp introduced no evidence of when the SanShoe product left Knapp's Brockton warehouse.

That observation extends beyond the conflict between Esser and Crabtree. Many of the findings made herein required crediting the testimony of one witness over the testimony of another.

Throughout the course of the trial, counsel for plaintiff seemingly advanced the suggestion that ex-employees of an employer — as a class — were and are not worthy of belief. That suggestion, in this court's view, is rather remarkable — not to mention inconsistent with controlling law. To the extent that conflicts in testimony appeared at trial, this court — using traditional indicia of truthfulness — credited those whose testimony was worthy of belief, regardless of whether they were formerly employed by Knapp, Sylvania, or anyone else for that matter.

employee for thirty years, had direct first-hand contact with the Shoney's, Marriott Host, Hilton and the Federal Express accounts. (Taylor, 15-65).

41. Taylor personally fitted customers on Knapp's shoe-mobile and was present for many of the Shoney's fittings. (Taylor, 15-25, 27). These fittings began in the spring of 1988. (Taylor, 15-60). The majority, if not all, of the shoes style numbered 2810 and 2930 which Taylor sold to Shoney's (and which Knapp is representing as being manufactured by Sylvania) were in fact manufactured overseas, by SanShoe. (Taylor, 15-11, 27, 28).

42. Taylor recognized these shoes as imports when he had to remove the silica gel packs from each shoe. Silica gel packs are placed in imported shoes to prevent moisture damage during shipping. (Taylor, 15-27, 28; Stalling, 15-85, 86).

43. When Shoney began to experience sole separation difficulties, Taylor personally investigated, retrieving many of the same imported shoes which he originally sold to Shoney's. (Taylor, 15-30).

E. *Non-Steel Athletic Style Shoes # 2820, 2825, 2940 & 2945*

44. The athletic style shoes sold to the food service industry had numerous sole adhesion problems.

45. Donald Stallings ("Stallings") was Knapp's Regional Sales Manager in Charlotte, North Carolina. (Stallings, 15-86). At least 90% of the shoes Stallings was responsible for were athletic styles. The athletic styles were imports from Taiwan. Stallings sold thousands of athletic slip-resistant shoes during the course of his career and never saw one that was made in the United States. (Stallings, 15-91, 92). Stallings testified that the majority of 2820, 2825, and 2940 sold on the Spartan

account were imports. (Stallings, 15-91). In addition to the silica gel packets, the boxes themselves were marked "made in Taiwan."[12] (Stallings, 15-118).

46. According to Taylor, style 2820 was not made domestically (Taylor, 15-15, 29, 37); style 2940 was made overseas (Taylor, 15-17); 2690 were imports (Taylor, 15-18); and 2820 were made overseas (Taylor, 15-39, 40).

47. Erin Duggan ("Duggan"), Knapp's National Accounts Manager from 1987-1990, testified that, in the non-steel toe shoes, Sylvania made only the plain-toe Oxford style 2810 and 2930, and not the athletic style shoe. (Duggan, 12-6). In fact, the only athletic style slip-resistant shoe Sylvania manufactured was a steel-toe product, not generally utilized in the food service industry. (Duggan, 12-6, 7). The non-steel-toe athletic style shoe were styles, 2820, 2825, 2940, and 2945. (Taylor, 15, 14-17; Stallings, 15-85). These non-steel-toe athletic style shoes were made offshore.[13] (Duggan, 12-6).

48. On July 21, 1989, Duggan wrote to Esser informing him of problems with the imported athletic style shoes. Duggan states: "The problem of sole separation, however, is not unique to [styles 2810 and 2930]. Specifically, I am aware of similar problems with Styles 2820 . . . 2600 . . . 2940 . . . 2960.[14]

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[12] Again, Knapp represented these shoes, all with sole adhesion problems, as being manufactured by Sylvania. (Crabtree, 15-123, 124).

[13] To this extent, Duggan's testimony supports that of Taylor and Stallings. Additionally, while Knapp sold thousands of athletic shoes to the food service industry, their own summary of Sylvania's invoices (Exhibit 6) demonstrates that Sylvania manufactured little athletic style shoes. Out of 277,700 pairs of shoes manufactured by Sylvania, 370 were in the athletic styles. Of these 370 pairs, 107 pairs were style 2820, 96 pairs were style 2940, and 167 pairs were style 2945. (Ex. 6). Sylvania never manufactured style 2825, and of the 11,976 pairs of the shoes Knapp returned to Sylvania, only three, style 2945, were an athletic style. (Ex. J).

[14] Styles 2820 and 2940 were also imported shoes.

As you can see, it is a problem affecting our entire slip-resistant line, hi-top, low-cut, steel-toe, non-steel toe, plain toe and athletic." (Ex. 26B).

49. With respect to all lines of shoes which Knapp requested be manufactured by Sylvania, one finding is unmistakenly clear: By their express negotiations,[15] by their express understandings, by their demonstrated conduct,[16] and by their express course of dealings, Sylvania promised Knapp that, in the event that shoes were defectively manufactured, Knapp's remedy, and *sole* remedy, would be the replacement of [or credit for]

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[15] Esser conducted all of the negotiations on behalf of Knapp, and, for the most part, Elliot conducted the negotiations on behalf of Sylvania. Those who now say that the understandings were different were not even associated with Knapp at the time of the negotiations. Esser and Elliot were, for want of a better term, "shoe people" — having been associated with the shoe industry for a number of years.

During the course of those negotiations, it was readily apparent that that which Knapp asked Sylvania to perform was, at once, both novel and risky, since that sort of construction was relatively new to the shoe industry and Sylvania had never manufactured that sort of shoe in the past. *See* paragraphs 20, 23 above. It was in that context, against his background, that the parties agreed that that would be the sole remedy.

[16] As stated by plaintiff in its requests for findings:

> By the fall of 1988, however, Knapp had to set up a separate area in its warehouse for all of the Sylvania defects. The quantity of returns had become great enough that Knapp implemented an internal audit system with an accounting document called an SA-7 in order to be able to get credits for returns. (Crabtree, 1-18, 1-20, 1-83; Ex. 1). An "exchange area" was set up to coordinate the returns to Sylvania for which Knapp would receive credit. (Crabtree, 1-19, 1-20).

If, as now suggested, plaintiff, or anyone on behalf of plaintiff, sincerely believed that plaintiff would be remitted to the panoply of remedies provided by the Uniform Commercial Code, given the alleged volume of defective returns, one would reasonably conclude that, as of the fall of 1988, Knapp would have seized upon one or more of those remedies. But Knapp did not; instead, it set up a return system — conduct consistent with Knapp's clear understanding that the sole remedy would be return of (or credit for) shoes shown to be defective. Indeed, it was not until *after* plaintiff had suffered deteriorating financial setbacks in unrelated matters, and *after* plaintiff was embarked on a course of seeking lower priced shoes from an offshore manufacturer, that plaintiff, for the first time, suggested that revocation of acceptance or rejection or repudiation were available remedies.

those shoes shown to be defective and returned — nothing more, and nothing less.[17]

F. *Pull Tests*

50. In October of 1988, Esser directed that samples of the Sylvania shoes be sent to the Footwear Institute of America ("FIA") for laboratory pull testing.[18]

51. The results of that FIA pull test indicated some problems caused by improper manufacturing. (Ex. 53, 54, 55). After reviewing the Footwear Institute of America's pull tests, Esser concluded the sole adhesion problems were minimal and continued to authorize purchases from Sylvania. (Esser, 15-85, 86).

52. Additionally, Sylvania had the shoes it manufactured tested by two separate cement companies. (Ex. U & V). These test results were satisfactory to Knapp. (Esser, p. 86).

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[17] This finding is not made and reported to suggest that Knapp waived its rights under Sections 2-601, 2-608, and 2-609 of the Uniform Commercial Code (M.G.L. c. 106, §§ 2-601, 2-608 and 2-609). Although it was and is clear to this court — then and now — that that was the sole understanding of the parties in terms of remedies and relief, and that it was clear (then and now) to all parties that the defense of waiver loomed throughout, and that plaintiff could not — then or now — establish any *legal* prejudice (that is, plaintiff could not — then or now — make any showing that the case would have been tried differently), our Court of Appeals, in the context of an interlocutory appeal relating to the dissolution of an injunction, has concluded otherwise.

Nevertheless, this finding and conclusion bears heavily on the credibility of the witnesses called by Knapp, and other issues to be determined herein.

[18] Laboratory pull tests are utilized in the footwear industry to determine the resilience of the adhesion bond between two shoe surfaces. The shoe is placed in a mechanical device which is designed to pull the shoe apart at a steady rate of speed. The machine measures the amount of force necessary to separate the upper from the midsole.

Knapp failed to specify in its contract with Sylvania any minimum number of pounds of pull pressure that it would deem satisfactory. There is no standard number in the footwear industry. (Esser, 5-48; Carbonneau, 4-61, 62; Petrie 8-74).

53. Esser concluded that the results of the FIA tests were "by and large satisfactory." (Esser, 5-86). Esser never rejected a Sylvania shipment, never considered stopping the Sylvania orders, *and* consistently authorized additional orders. (Esser, [illegible], 82, 86, 89, 90).[19]

54. Sprague was concerned, however, that some of the sole adhesion failures were due to the wearing of the EVA shoes in inhospitable environments. Sprague testified to recognizing the smell of chemicals on some of the returned shoes. Knowing certain chemicals could weaken EVA's adhesive bond, Sprague recommended changing from EVA midsoles to a polyurethane sole. (Sprague, 8-27, 28).

55. In approximately December of 1988, Sylvania complied with Sprague and converted all the men's shoes to polyurethane.

56. Both Esser and Sprague testified that there were never any complaints of sole adhesion on Sylvania shoes constructed with poiyurethane. (Esser, 5-93; Sprague, 8-28).

G. *Knapp's Deteriorating Financial Problem*

57. By February, 1989, Knapp's financial situation had "deteriorated rapidly." (Esser, 5-95). Esser was receiving daily phone calls from various vendors with receivables over sixty and ninety days. For the most part, Knapp was in arrears with all of its vendors. (Esser, 5-96, 99).

58. In April, 1989, Knapp's President, Richard, Nedder, left the company. (Esser, 5-96).

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[19] Esser's conclusions were shared by John Sprague ("Sprague"). Sprague, in charge of Quality Control and Product Development at Knapp, testified that the problem with sole adhesion "was not a severe problem." (Sprague, 8-18). "As far as that whole picture goes, all those shoes that were made by Sylvania Shoe, in my mind, it [sole adhesion] was not a major problem." (Sprague, 8-30).

59. A cash committee was established at Knapp, consisting of Knapp's top management, to determine how much cash was available, and which vendors would be paid. (Esser, 5-95, 96).

60. In July, 1989, Knapp's new president was Joel Murray.

61. In addition to facing its serious cash flow dilemma, Knapp was also facing a major inventory problem. Sales fell far below projections on some style shoes, resulting in unmovable stock, while Knapp was in critical need of cash to purchase inventory on those styles which were selling. (Esser, 5-97).

62. On July 14, 1989, Pearlstein of Sylvania wrote to Knapp expressing concern that Knapp was not paying Sylvania's bills in a timely fashion. (Ex. P).

63. On July 27, 1989, a meeting occurred between Pearlstein of Sylvania and Esser and Sprague of Knapp. (Elliot, 7-21; Ex. 75). Sylvania's outstanding balance at the time was approximately $300,000. (Esser, 5-99).

64. Knapp made some token payments unrelated to claimed defects. (Sebastiao, 7-14).

65. Knapp only made token payments for two reasons. First, Sylvania, unlike other vendors, was continuing to deliver shoes, despite Knapp's outstanding balance. (Esser, 5-100). Second, Knapp realized that overseas manufacturers had developed slip-resistant shoes at significantly less expense. (Esser, 5-99).[20]

66. On September 6, 1989, Pearlstein again wrote to Knapp expressing concern about Knapp's outstanding balance. (Ex. Q). Pearlstein talked with Murray and a meeting was set for October 17, 1989.

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[20] Knapp was investigating an overseas manufacturer called Nirach. Nirach had developed an updated athletic slip-resistant shoe that had a "more sophisticated midsole and heel support system." (Esser, 5-98, 99).

67. Prior to this meeting, Murray asked Esser whether the rumors that there were problems with the quality of Sylvania's shoes was accurate. Esser informed Murray, ". . . they have not proven to be major problems. It appears to be more hearsay than it is a fact, because I have no returns and no documents to show the extent of the problem." (Esser, 5-104).

68. Murray then had Sprague bring in half a dozen to a dozen of Sylvania's shoes. Esser testified that "we tried to pull the soles off of the shoes. And one shoe we were able to pull the sole off at the heel." (Esser, 5-105).

69. On October 17, 1989 Pearlstein, Murray, and Esser met. At this time Knapp's debt to Sylvania had grown to over $400,000. (Pearlstein, 9-5).

70. Murray attempted to separate the soles of Sylvania shoes in front of Pearlstein. After bending and torquing the shoe, at one point over his thigh, Murray ended up with about one half inch separation. (Pearlstein, 9-13).

71. Murray agreed to pay $40,000 for every $35,000 worth of product Sylvania sent. (Ex. 60; Murray, 4-99).

72. Subsequent to the Murray/Pearlstein meeting, Esser again investigated the sole separation problem and again determined "there was not a major problem with the footwear." (Esser, 5-110).

73. On December 1, 1989, Dick Sebastiao ("Sebastiao") became Executive Vice President of Knapp, and on February 15, 1990, Sebastiao became President of Knapp.

74. In January, 1990, Murray authorized two minimal checks to Sylvania in the amount of $20,000 each for payment on the past due accounts. (Sebastiao, 10-10, 14).

H. *Knapp Rejects Sylvania's 1990 Shipment*

75. On January 29, 1990, Knapp ordered approximately 1,434 pairs of shoes from Sylvania. Those shoes were received by Knapp on February 2, 1990.

76. James Crabtree ("Crabtree") of Knapp, reported to Sebastiao that he had personally inspected the 1990 shipment and determined 100% in every style was defective. (Crabtree, 1-28, 30).[21] He brought it to the attention of Sebastiao. Sebastiao sent a case to Pearlstein for inspection.

77. Pearlstein inspected a sample of these 1990 shoes and determined that the shoes were not defective. (Pearlstein, 9-13).[22]

78. After the 1990 shipment, Crabtree was asked by Sebastiao to check the warehouse inventory. (Crabtree, 1-33). Crabtree simply pulled out a random number of shoes, said that he pulled them apart by hand, and said that he determined the percent of defect was 95%. (Crabtree, 1-34). There was no effort to engage in any sort of statistical sampling of the warehouse. However, Esser, and Sprague, had also checked the inventory and found no such sole adhesion catastrophe.

79. Prior to this 1990 shipment, Knapp had customer returns of less than 1.5% for four out of five styles in this 1990 shipment

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[21] In the circumstances, this court finds and concludes that Crabtree was not credible on this score, for the reasons set forth in paragraph 77 immediately below.

Additionally, Crabtree's alleged inspection results are inconsistent with prior determinations by other Knapp employees. These employees had greater responsibility within Knapp and had far more extensive experience within the footwear industry than Crabtree had. (Ex. 1). Most notably, these Knapp employees are Esser and Sprague who were responsible in all respects for the Knapp/Sylvania venture and who, as previously noted, stated the defect problem was not of great concern.

[22] Given the testimony of Pearlstein on this score — which this court credits — this court finds and concludes that Crabtree's alleged findings are unworthy of belief.

(these four styles were the 2600 line). The return rate on the remaining style, style 2935, had been 5.4%. (Esser, 5-70; Ex. J).

I. *Knapp Revokes Acceptance on Entire Sylvania Inventory*

80. As a result of Crabtree's 1990 inspection, Knapp claimed to possess 13,022 pairs of defective shoes in its warehouse. (Ex. 3). Many of these shoes had been sitting in Knapp's warehouse between one and two years.[23]

81. Sebastiao became President of Knapp in February, 1990. (Sebastiao, 1-89). He left five months later, in July 1990, to take over liquidation of the Foster Grant company. (Sebastiao, 1-89). Sebastiao specialized[24] in "turn-around work and crisis management work." (Sebastiao, 1-91, 99). One of Sebastiao's first acts as president of Knapp was to reject the 1990 shipment. On May 14, 1990, Sebastiao gave formal notice[25] purportedly rejecting the 1990 shipment, revoking

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[23] And yet plaintiff — notwithstanding the clear understanding between the parties as to their respective rights and liabilities, *see* note 17 above — also admitted to throwing allegedly defective shoes into a "dumpster." (Crabtree, 1-19, 20; Murphy, 10-100, 101).

The relationship between the parties in this matter started in 1986. Again — notwithstanding the clear understanding between the parties as to their respective rights and liabilities, *see* note 17 above, not to mention the deteriorating financial condition of Knapp and its concomitant needs for cash (which would have been fulfilled if Knapp returned defective shoes for credit) — it appears to be remarkable that Knapp waited until January of 1990 to claim that it had some 13,000 defective shoes which had been manufactured by Sylvania.

[24] Although Sebastiao, in that role, may have been engaged in the business of shoes, it is clear that he — unlike the principals who negotiated all of the terms of the relationship between Knapp and Sylvania — was not actively engaged in the shoe business.

[25] Sebastiao testified that he had orally advised Pearlstein that Knapp was rejecting the 1990 shipment, and revoking acceptance of shoes previously received, on March 2, 1990. In the circumstances, this court does not credit that testimony, and finds and concludes that the first such notice — formal or otherwise — was in the May 14, 1990 Letter (# 14).

After March 2, 1990, Knapp continued to do business with Sylvania. And on March 15, 1990, Pearlstein, on behalf of Sylvania, wrote a letter to Sebastiao (Ex. 11)

acceptance of virtually all of Sylvania's shoes in Knapp's inventory, and repudiating any and all agreements for further shipments. (Ex. 14).[26]

82. Sebastiao's May 14, 1990, letter which revoked acceptance of the entire lot of shoes in Knapp's warehouse, also repudiated the orders for another $278,216.66 worth of shoes which Knapp ordered and Sylvania had manufactured but not yet delivered. (Ex. 14; Pearlstein, 9-15).

83. On June 7, 1990, Sylvania, in response to Knapp's repudiation of finished goods and work in process, offered Knapp the opportunity to inspect the goods at Sylvania and additionally, offered to send the shoes for testing at a laboratory of Knapp's choosing, at Sylvania's expense. (Ex. B). Knapp has never accepted the offer.[27]

84. When Sebastiao rejected the 1990 shipment, he had been investigating having the shoes manufactured at a lesser expense in Taiwan.

85. Sebastiao sent a fax to the Taiwanese buying agent, expediting the production and shipment of the off-shore shoes to Knapp. (Sebastiao, 1-141).

J. *Proposed Loss of Business*

86. The sole separation difficulties with Spartan in 1988, did not seriously affect Knapp's potential for business with

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seeking payment for prior shipments, *including* the February shipment. It is hardly likely that Pearlstein would have, rather matter-of-factly, sought payment for that particular shipment if Sebastiao had given prior notice of rejection of that shipment, not to mention prior notice of revocation of acceptance of all shoes in Knapp's warehouse.

[26] Which had the effect, of course, to effectively erase Knapp's debt to Sylvania — a financial plus to a company which had been experiencing cash flow problems.

[27] Knapp's response appears to be this lawsuit.

Regan ("Regan"), Knapp's Head of Industrial Sales in 1989, stated that he could have sold a large quantity of slip-resistant shoes to Hardee's but for the fact that Knapp did not have sufficient money to purchase shoes from Sylvania or anyone else. (Regan, 14-25, 27). At all relevant times, Knapp was on the Hardee's list of approved vendors. (Ex. AAA).

87. Additionally, Ms. Carrick of Marriott informed the Marriott parent corporation that, despite the problem with the Knapp shoes in 1988 and 1989, the Marriott Host was "open to see a new shoe and try a new shoe with [Knapp]." (Carrick, 11-40). Knapp continues to be an approved vendor for Marriott, although not the recommended vendor. (Carrick, 11-38).

II. CONCLUSIONS OF LAW

Plaintiff's Claims

A. *BREACH OF WARRANTY CLAIMS (Counts 3 and 4)*

Plaintiff alleges that Sylvania breached warranties of merchantability (M.G.L. c. 106, § 314) and fitness for a particular purpose (M.G.L. c. 106, § 315) insofar as the shoes experienced sole adhesion and other maladies. Sylvania does not contest — indeed, never has contested — that it breached these warranties to the extent that plaintiff has shown that particular shoes were defective for whatever reason.[28] Beyond replace-

[28] Under M.G.L. c. 106, § 6-314, to be merchantable, Sylvania manufactured shoes must pass without objection in the footwear industry and be fit for the ordinary purpose for which shoes are manufactured. M.G.L. c. 106, § 2-314(2). "Merchantable" is further defined as goods of average quality. *Computerized Radiological Services* v. *Syntex Corporation*, 595 F.Supp. 1495, 1508 (Mass. 1984). That is, the goods must be of such a quality or character that they are reasonably suited for ordinary uses for which goods of that kind are sold. *Delano Growers' Cooperative Winery* v. *Supreme Wine Co., Inc.*, 473 N.E.2d 1066, 1071 (Mass. 1985).

Under M.G.L. c. 106, § 6-315, fitness for a particular purpose means that the seller warrants that the goods — in this case, shoes — were fit for their intended use.

ment of (or credit for) shoes actually shown to be defective, however, plaintiff seeks more: Plaintiff seeks (1) revocation of acceptance [and the attendant monetary damages for] all shoes previously accepted and stored in its warehouse; (2) rejection [and the attendant monetary damages for] of the February shipment of some 1300 shoes; (3) repudiation of any and all agreements to accept shoes manufactured by Sylvania on Knapp's account not yet delivered; (4) loss of profits; (5) and damages for loss of reputation.

This court, for the reasons more fully set forth below, finds and concludes that plaintiff is entitled to damages — indeed, a matter not in dispute — for those shoes actually shown to be defective, but for nothing else.

1. *Revocation of Acceptance (M.G.L. c. 106, § 2-608)*

Plaintiff seeks to revoke acceptance of, and receive damages for, all shoes previously shipped to it by Sylvania and which remain in Knapp's warehouse.

Revocation of acceptance is governed by the provisions of M.G.L. c. 106, § 2-608. The statute provides:

> § 2-608. Revocation of Acceptance in Whole or in Part
>
> (1) The buyer may revoke his acceptance of a lot or commercial unit whose non-conformity substantially impairs its value to him if he has accepted it
>
> (a) on the reasonable assumption that its non-conformity would be cured and it has not been seasonably cured; or
>
> (b) without discovery of such non-conformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

(2) Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. It is not effective until the buyer notifies the seller of it.

(3) A buyer who so revokes has the same rights and duties with regard to the goods involved as if he had rejected them.

Substantial Impairment

Under § 2-608, a buyer who seeks to revoke acceptance of a commercial lot of goods on account of a defect of some of the goods in that lot must show, by a *preponderance of the evidence*, among other things: (1) that the non-conformity shown *substantially impaired* the value of the goods to the buyer;[29] *Axion Corporation* v. *G.D.C. Leasing Corporation*, 269 N.E.2d 664, 667 (Mass. 1971) (since goods were accepted, buyer has burden of establishing breach); *see also G.M.A.C.* v. *Jankowit*, 523 A.2d 695, 705 (N.J.Super.A.D. 1987) (buyer has burden to prove revocation was proper and justified, including proof that breach caused a substantial impairment in the value of the goods to the revoking buyer); *Wetherell Corporation* v. *Kingston Pipe Industries, Inc.*, 1992 WL 280535 (Conn. Super. 1992) (buyer has the burden of establishing any breach with respect to previously accepted goods); *and* that (2) revocation occurred within a reasonable time after the non-conformity was or should have been discovered. *Fortin* v. *Ox-Bow Marina*, 557 N.E.2d 1157, 1162 (Mass. 1990).

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[29] Both Professors Priest and Sebert have concluded from a review of the cases determined under Section 2-608 that the burden imposed on the merchant buyer is greater than that imposed on the "consumer" buyer. *See* Sebert, Rejection, Revocation and Cure under Article 2 of the Uniform Commercial Code: Some Modest Proposals, 84 Northwestern University L.R. 375, 406 and n.161 (1989-1990).

In the circumstances, this court cannot fairly conclude that plaintiff has established by a preponderance of the evidence that the non-conforming shoes which did exist *substantially impaired* the value of any particular lot — much less the value of all goods shipped and accepted since 1987.

Whether there is substantial impairment to the value of the goods is viewed in light of the "totality of the circumstances" of each particular use. *Fortin, supra*, at 1162. The totality of the circumstances analysis encompasses the number of deficient goods and the basis for the non-conformity. *Id.* The test is primarily an objective one — requiring a showing that the impaired value of the goods is substantial, not trivial.[30]

Although, for reasons not apparent to this court, particularly given the nature of the claims, none of the parties have chosen to brief the law on this matter.[31] Massachusetts case law pro-

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[30] Professor Sebert suggests that the relevant inquiry is not dissimilar to the inquiry made to determine the existence *vel non* of a material breach under the *Restatement (Second) of Contracts*.

> It is interesting, but not surprising, to note that the five factors that have been important in substantial impairment determinations under section 2-608 are similar to those listed by the Restatement (Second) of Contracts as significant in determinations concerning material breach. The Second Restatement's five factors are:
>
> (a) the extent to which the injured party will be deprived of a reasonably expected benefit;
>
> (b) the extent to which the injured party can be compensated adequately for any breach;
>
> (c) the extent to which the breaching party will suffer forfeiture if the breach is deemed material;
>
> (d) the likelihood that the breaching party will cure his breach; and
>
> (e) the extent to which the breaching party's actions comport with the standard of good faith.

See Sebert, Rejection, Revocation and Cure under Article 2 of the Uniform Commercial Code: Some Modest Proposals, 84 Northwestern University L.R. 375, 405 (1989-1990).

[31] For its part, plaintiff, in its requests for findings and conclusions, simply says that there was a substantial impairment — without any further elaboration. Defendant says no more.

vides some guidance as to what percentage of defective goods will substantially impair the value of the goods to the buyer. In *Sierra Marketing* v. *New England Wholesale Co.*, 438 N.E.2d 1101 (Mass. App. 1982), the Massachusetts Appeals Court upheld the trial court's finding that an 11% defective rate amongst previously accepted goods did not substantially impair the value of the whole of the goods to the buyer.[32]

In *Sierra*, the buyer accepted and partially paid for 900 cast iron doors to be utilized in the assembly of wood burning stoves. When defects on some of the doors surfaced, the buyer asserted a breach regarding all of the accepted goods.

The *Sierra* court reasoned that, despite the credible expert testimony regarding an allege design defect, there was an abundance of evidence to support the judge's finding that no more than 100 doors were defective.[33]

This lack of attention to matters of importance hardly facilitates the just and speedy resolution of claims. In their respective memoranda and reply memoranda, the respective parties simply assumed the existence of facts [the most favorable facts, of course], and reached conclusions based thereon. In this case, as in most cases, of course, the truth lay somewhere in between.

[32] This case does *not* present an issue as to whether particular pairs of shoes with sole separation problems are "substantially impaired." Defendant does not gainsay that fact. Rather, the question here is whether sole separation maladies appertaining to a certain percentage of the pairs of shoes shipped within a commercial lot "substantially impaired" the commercial lots as a whole.

[33] One hundred defective doors out of nine hundred doors accepted, produces a defective rate of 11%. To be sure, there was also testimony in *Sierra* that other buyers experienced a failure rate of only one to two percent. This rate was found inherent in any cast iron product and an explanation of the 11% defective rate experienced by Buyer was that forfeiture would occasionally produce a bad "batch" of doors.

This case is quite unlike that in *Fortin* v. *Ox-Bow Marina*, 557 N.E.2d 1157, 1162 (Mass. 1990), a case not even cited by plaintiff. *See* note 30. In *Fortin* the court determined that a trouble-plagued power boat substantially impaired the boat's value to the buyer. The evidence indicated that the engine overheated twice, the bilge pump was defective, there was an array of malfunctioning electrical equipment, and the toilet only functioned partially. Utilizing the totality of the circumstances analysis, the court determined these defects substantially impaired the value of the goods to the revoking buyer.

In this court's view, plaintiff's claim of substantial impairment, first echoed in May of 1990, rings hollow in the circumstances.

Despite some problems with sole separations on style 1251, Knapp continued to purchase style 1251 from Sylvania. (Esser, 5-21, 22, 24). Knapp continued to order style 2600 series despite the fact that in August of 1988, Knapp received reports from its retail locations that there were sole separation problems with the style 2600 line. (Esser, 5-75).

Because there were complaints from Knapp's customers about sole adhesion failure, Esser and Sprague, both employees of Knapp, took careful steps to monitor and assess the extent of the sole separation problem.

First, Knapp inspected the Sylvania shoes more carefully than other shoes, and with more frequency. (Esser, 5-75).

Second, Esser constantly monitored the return rates of the Sylvania shoes in the warehouse and in the field and received reports personally. (Esser, 5-81, 86, 89). Esser testified: "In other words, I would monitor the amount of defective shoes being returned." (Esser, 5-81).

Third, Esser was aware of and responded personally to the complaints about sole adhesion problems from specific customers.

Fourth, Knapp requested that Sylvania obtain periodic "pull tests" to measure the strength of the adhesive bond "to make sure we didn't have a problem," and Knapp checked these results. (Esser, 5-75).

Fifth, Knapp contracted with the Footwear Institute of America (F.I.A.) to test and analyze Sylvania shoes for sole adhesion problems.

One could reasonably conclude that a buyer who buys a single boat which turns out to be the proverbial "lemon" may assert substantial impairment. It is not so here.

As a result of Esser's investigation, he believed that the sole adhesion problem was "not a major problem" even in late 1989. He felt that the F.I.A. test results were "by and large satisfactory." (Esser, 5-86). After carefully monitoring returns and customer complaints and from the testing of shoes, Esser never rejected a Sylvania shipment, never considered stopping the Sylvania orders and always authorized additional orders. (Esser, 5-77, 82, 86, 89, 90).

Furthermore, Sprague also carefully monitored the situation. He personally examined the Sylvania shoes that were returned from customers and on several occasions even went through Knapp's inventory and inspected Sylvania shoes that had not yet been shipped to customers. (Sprague, 8-17). He concluded, in his capacity as quality control person for Knapp, that the problem with sole adhesion "was not a severe problem." (Sprague, 8-18). "As far as the whole picture goes, all those shoes that were made by Sylvania shoe, in my mind, it [sole adhesion] was not a major problem." (Sprague, 8-30).[34]

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[34] Knapp, in an attempt to demonstrate that Sylvania manufactured shoes were of substantially impaired value to Knapp, introduced the testimony of their expert, Eugene Poggio ("Poggio"). Poggio used a statistical formula to determine the number of defective shoes in Knapp's inventory.

Poggio considered a shoe to be "defective" if the pull test result on any one of five points was less than 20 pounds. (Poggio, 13-14). Additionally, Poggio deemed both shoes in a pair defective if only one of the shoes was defective.

Poggio, a biostatistician, readily acknowledged that, "I don't consider myself qualified to define 'defective' for a pair of shoes." (Poggio, 13-18). Rather, Poggio testified that Mr. Bonn, counsel for Knapp, supplied him with the definition of "defective."

However, there was no testimony at trial that a pull test result of 20 pounds on any one point of a shoe rendered the shoe "defective." To the contrary, all of the testimony indicated that there was no generally accepted standard for pull test results. Furthermore, Knapp had not specific any particular pull test result. *See D'Orsay Equipment Co.* v. *United States Rubber Company*, 199 F.Supp. 427, 431 (Mass. 1961) (plaintiff failed to establish what, in fact, was encompassed with "normal manufacturing tolerances").

Finally, there is no certainty as to whether the shoes Poggio determined to be defective were in fact manufactured by Sylvania or were imported shoes.

Thus, from a purely objective point of view, the credible testimony, that is, the testimony of those intimately familiar with the shoe business, simply fails to establish a substantial impairment within the meaning of Section 2-608. Notwithstanding the fact that Knapp was fully aware of the fact that defective shoes could well be included within shipments of commercial lots, Knapp continued to order those lots, and resell to its customers at a profit. Its belated claim of "substantial impairment" — from an objective point of view — simply blinks reality.

To be sure, plaintiff, relying on *Fortin, supra*, contends that "substantial impairment" is not subject only to an objective test — that is, that the test also involves a degree of subjectivity as well.

Plaintiff is correct as to the law, but short on the fact in this case. In *Fortin*, the Court clearly stated that "lost confidence" was a factor to be considered under Section 2-608.[35] But in this

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[35] "In weighing this issue the trier of fact must decide whether the defects substantially impair the value of the goods to the revoking buyer, c. 106, § 2-608(1). Most courts read this test as an objective, or common sense, determination that the impaired value of the goods to the buyer was substantial as opposed to trivial, or easily fixed, given his subjective needs. *See Black* v. *Don Schmid Motor, Inc.*, 232 Kan. at 462; 4 R.A. Anderson, Uniform Commercial Code § 2-608:23, at 187 (3d ed. 1983). The evaluation is made in light of the 'totality of the circumstances' of each particular case, including the number of deficiencies and type of nonconformity and the time and inconvenience spent in downtime and attempts at repair. *Rester* v. *Morrow*, 491 So.2d 204, 210 (Miss. 1986). *See Jackson* v. *Rocky Mountain Datsun, Inc.*, 693 P.2dss 391, 393 (Colo. Ct. App. 1984); *Conte* v. *Dwan Lincoln-Mercury, Inc.*, 172 Conn. at 121. *Black* v. *Don Schmid Motor, Inc.*, 232 Kan. at 464-66. *McCullough* v. *Bill Swad Chrysler-Plymouth, Inc.*, 5 Ohio St. 3d at 185-86. Thus, it has been said that, in the proper circumstances, even cosmetic or minor defects that go unrepaired despite a number of complaints or attempts at repair, *McCullough* v. *Bill Swad Chrysler-Plymouth, Inc.*, *supra* at 185; *Ybarra* v. *Modern Trailer Sales, Inc.*, 94 N.M. at 251; 4 R.A. Anderson, Uniform Commercial Code, *supra* at § 2-608:24, at 189, or remaining minor defects after an earlier, serious problem has been repaired, *Rester* v. *Morrow*, *supra* at 210; *Welch* v. *Fitzgerald-Hicks Dodge, Inc.*, 121 N.H. at 364, or defects which do not totally prevent the buyer from using the goods, but circumscribe that

case, this court cannot fairly conclude that it was "lost confidence" which prompted the revocation.

First and foremost is the matter of timing. Defendant has never suggesed that a certain portion of the shoes shipped and accepted did not have defects. And, of course, even now that is not the point. To the extent that a buyer's subjective expectations factor into the substantial impairment calculus, the claim of such — to the extent that it is made[36] — rings hollow. For the long and short of that matter is that it was first, not to mention formally, made in May 1990 — by the then Chief Operating Officer, Sebastiao, who, by his own account, had no familiarity with the shoe industry,[37] and who was with Knapp only since December 1989. That sudden revelation that the value of the agreement that Knapp had had with Sylvania for some three years had been "substantially impaired" — only *after* Knapp suffered financial mishaps with respect to other divisions, *after* Knapp sought to buy shoes of the same style offshore at a lesser price, and even *after* Knapp, not less than three months earlier,[38] ordered yet another 1434 pairs of shoes

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use or warrant unusual or excessive maintenance actions in order to use, *Black* v. *Don Schmid Motor, Inc.*, *supra* at 466; *Erling* v. *Homera, Inc.*, 298 N.W.2d 482, can substantially impair the goods' value to the buyer. Experiencing in a major investment a series of defects, even if some have been cured and others are curable, can shake a buyer's faith in the goods, at which point "the item not only loses its real value in the buyer's eyes, but also becomes an article whose integrity has been substantially impaired and whose operation is fraught with apprehension.' *Lathrop* v. *Tyrell*, 128 Ill. App. 3d 1067, 1068-69 (1984). *See Tiger Motor Co.* v. *McMurtry*, 224 So.2d 638, 646-47 (Ala. 1969); *Durfee* v. *Rod Baxter Imports, Inc.*, 262 N.W.2d at 354; *Rester* v. *Morrow*, 491 So.2d at 210-11; *Welch* v. *Fitzgerald-Hicks Dodge, Inc.*, 121 N.H. at 364; *McCullough* v. *Bill Swad Chrysler-Plymouth, Inc.*, 5 Ohio St. 3d at 186."

[36] Once again, plaintiff has not even addressed the issue in terms of a subjective determination of substantial impairment.

[37] Sebastiao was originally an "audit manager" with an accounting firm. He describes himself as an "independent consultant, self-employed, doing turn-around and crisis management work."

[38] January 29, 1990, to be exact.

— blinks reality and common sense. In the circumstances, the claim of "substantial impairment" — not to mention the formal claim memorialized in Knapp's letter to Sylvania (Plaintiff's Exhibit 14)[39] — rings hollow and false.[40]

In short, plaintiff has not established by a preponderance of the evidence that the alleged defects of some of the shoes in the various lots "substantially impaired" the value of the entire lots within the meaning of Section 2-608, and revocation of acceptance is *not* an appropriate remedy.

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[39] That letter, obviously prepared with a view towards the formal requirements of revocation of acceptance under the Uniform Commercial Code, was imbued with all the necessities. But it, like Sebastiao's testimony, likewise rings hollow.

[40] Of course, inasmuch as Knapp ordered the shoes for purposes of fulfilling contracts with others, it could be argued that the contract between Knapp and Sylvania was "substantially impaired" because of [Knapp's] customers terminating their respective programs to buy the shoes.

That suggestion is not argued as such. *See* note 30, above. Plaintiff does matter-of-factly indicate (Proposed Findings of Fact and Conclusions of Law of Plaintiff Knapp Shoes, Inc. (# 139, pp. 34-47) that some of its customers terminated its shoe buying program with Knapps. But those alleged "facts" do not support the conclusion of "substantial impairment."

First and foremost, that evidence was received as "customer complaints." When plaintiff initially attempted to introduce that evidence by and through one of its employees, defendant objected on grounds of hearsay. Plaintiff then proffered the evidence as "customer complaints" — not for the truth of the matter asserted therein.

Equally important is the fact that plaintiff has not established that defective shoes manufactured by *Sylvania* were the reason for customer satisfaction, for, as indicated above, there was strong and compelling evidence that shoes which proved to be defective when in the hands of the customers were manufactured offshore.

And finally, the matter of timing, once again, looms large. Most of the cancellations referred to by plaintiff occurred well before February — and certainly well before May — 1990. One would think that, if plaintiff was really dissatisfied in terms of cancellation of existing programs with other customers, complaints of that dissatisfaction would have come on the heels of those cancellations — not months or years later. Once again, it must be pointed out that plaintiff first voiced its concern of "substantial impairment" only *after* Knapp suffered financial mishaps with respect to other divisions, *after* Knapp sought to buy shoes of the same style offshore at a lesser price, and even *after* Knapp, not less than three months earlier, ordered yet another 1434 pairs of shoes from Sylvania.

Timeliness of the Revocation

Even if plaintiff could establish "substantial impairment" by a preponderance of the evidence — and it has not done so in the circumstances of this case — plaintiff must also show, under Section 2-608(2), that its revocation of acceptance was made in a timely fashion. It has not done so in the cicumstances of this case.

Although there is no bright line struck in Section 608(2) as to what constitutes a timely revocation,[41] the Massachusetts Supreme Judicial Court has carved relevant parameters. In *Axion Corporation* v. *G.D.C. Leasing Corporation*, 269 N.E.2d 664, 667 (Mass. 1971), that court observed, *inter alia*:

> As a matter of law, after delay of more than a year, the notification was not "seasonable," and the rejection was not "within a reasonable time." *Miron* v. *Yonkers Raceway, Inc.*, 400 F.2d 112, 118-19 (2d Cir.). *Ingle* v. *Marked Tree Equip Co.*, 244 Ark. 1166, 1173-74. *Woods* v. *Van Wallis Trailer Sales Co.*, 77 N.M. 121, 123. *Julian C. Cohen Salvage*

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[41] Plaintiff dwells on the fact that plaintiff allegedly received consistent reassurances that the defects would be cured. To the extent that plaintiff means by this that plaintiff expected that it would receive lots of shoes with no defects whatsoever, the record does not support it. For, given the method of shoe manufacture, no one could reasonably expect that *all* shoes would be without defect.

But all of this, once again, is beside the point. Whether or not such reassurances were offered, even on a consistent basis, is a matter of focus under Section 608(1) — not Section 608(2). Section 608(1) simply says that such reassurances of cure does not bar further remedies — even if the buyer accepts the goods, or lots of goods, with knowledge of the defects.

In this case, Sylvania has never suggested that acceptance of the goods with knowledge of defects constitutes a bar to redress. And, indeed, Sylvania goes further — not gainsaying the fact that it made reassurances: Not the reassurances which plaintiff suggests, but reassurances that it would use its best efforts to consistently manufacture conforming shoes, and, in any event, to replace (or give credit for) those shoes actually defective.

But none of this addresses the question of timeliness of revocation under Section 608(2).

Corp. v. *Eastern Elec. Sales Co.*, 34 D. & C. 2d (Pa.) 705, 710, *aff'd* 205 Pa. Super. 26. *Campbell* v. *Pollack*, 101 R.I. 223, 230. Compare under the Uniform Sales Act, *Moore* v. *Foss & Co., Inc.*, 18 F.2d 635, 637 (D. Mass.); *United States* v. *D. C. Loveys Co.*, 174 F.Supp. 44, 47-48 (D. Mass.)., *aff'd sub nom. A. Belanger & Sons, Inc.* v. *United States*, 275 F.2d 372 (1st Cir.).[42]

Applying these principles to the present case, it is clear that the purported revocation of acceptance was untimely under any standard. As indicated above, plaintiff seeks revocation of all goods, without further identification, received during the course of a period of some three years. This is not a case where plaintiff could not have reasonably discovered that defects existed in the commercial lots; to the contrary, it is clear beyond peradventure that plaintiff was aware of that fact by its very course of dealings with the defendant — *i.e.*, the establishment of a means by which to return defective shoes and obtain credit therefor. Fully aware that defects existed, plaintiff nevertheless chose to accept shipments as ordered. More to the point, plaintiff accepted the lots of shoes as ordered, and continued to resell and profit therefrom shoes as ordered by its customers. Plaintiff would have it both ways. Accept the goods and make a profit thereon, on the one hand, and, on the other, when financially pressed on account of conditions wholly divorced from the dealings between plaintiff and defendant, do an about face and say that it never intended to finally accept the whole in the first place. In these circumstances, it cannot be fairly said that plaintiff's revocation of

[42] The quoted text related to the issue of whether a rejection under Section 2-606(2) was timely. In context, however, it is clear that the quoted language applies equally to revocation of acceptance under Section 2-608, since elsewhere that court observed "it might be more appropriate to treat the problem as one of revocation of acceptance."

acceptance was "seasonable" within the meaning of *Axion Corporation* v. *G.D.C. Leasing Corporation, supra.*

2. *Repudiation (M.G.L. c. 106, § 2-609)*

Plaintiff further seeks a declaration to the effect that it was and is not required to take delivery of certain goods not yet shipped from the Sylvania premises, completed goods or goods in progress, on the grounds that Sylvania had failed to provide adequate assurance of performance under the provisions of M.G.L. c. 106, § 2-609. Defendant, for its part, contends that it provided adequate assurance, and that plaintiff chose not to even inspect the goods, even after its offer to that effect. In the circumstances, however, this court finds and concludes that there is no occasion to determine whether adequate assurance was provided within the meaning of § 2-609. And that is because, as discussed *infra*, pp. 41-44, plaintiff is entitled to the declaration that it seeks on other grounds, to wit: plaintiff is not liable to defendant in damages for want of proof by defendant to minimize its damages as required by statute. M.G.L. c. 106, § 2-709.

3. *Rejection of Goods (M.G.L. c. 106, § 2-601)*

Plaintiff also contends that it is entitled to reject the delivery of the approximately 1,434 pairs of Sylvania manufactured shoes, ordered in January 1990, and delivered in February 1990. That contention, however, is based solely on the testimony of Knapp's employee, Crabtree's, testimony which this court finds incredible in the circumstances. According to Crabtree, using a so-called "hand test," he determined that one hundred percent of the shoes in that shipment were defective. Quite apart from Crabtree's rather unorthodox method of test-

ing,[43] this court cannot fairly credit the testimony of Crabtree. According to Sebastiao, a case of the shoes from within the February 1990 shipment was sent to Pearlstein at Sylvania for verification, and Pearlstein testified that none within that case separated as testified to by Crabtree. The testimony of Pearlstein was clearly the more incredible, and plaintiff has failed to establish by a preponderance of the evidence that any of the shoes — much less the whole of the lot — failed to conform to the terms of the contract.

Moreover, rejection under the provisions of § 2-601 must be made within a reasonable time after their delivery or tender. Rejection is ineffective unless the buyer seasonably notifies the seller. *See* M.G.L. c. 106, § 2-602. In the circumstances, this court cannot fairly conclude that plaintiff has established by a preponderance of the evidence that the rejection was "seasonably" made within the meaning of § 2-602. The shoes were ordered on January 29, 1990, and delivered in February 1990. The rejection was not tendered until May 14, 1990. This three-month period in which Knapp waited to reject the shoes cannot be deemed reasonable. Because Knapp experienced prior problems with the sole adhesion, it surely should have exercised due diligence in inspecting the shoes as they arrived, instead of merely visually looking at the shoes and waiting three months before rejecting shipment. *See SCA Inter-*

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[43] According to Crabtree, he determined that 100% of the shoes were defective by simply putting the upper in one hand and the bottom in his other hand and just pulling it apart.

> "So, I grabbed another one out of the same case, and did the same thing, just pulled them apart, just separating at the heel."

Crabtree acknowledged, however, that a "hand" pull test is not the same as a mechanical pull test, and that he did not know how many pounds of pressure it takes to pull off the sole of a shoe with his hands. (Crabtree, 1-47, 48). Moreover, the Uniform Commercial Code holds the parties to the standard of testing accepted in the industry. M.G.L. c. 106, § 1-205. And it is clear from the testimony before this court from both plaintiff and defendant that a standardized mechanical pull test is the industry standard.

national, Inc. v. *Garfield & Rosen, Inc.*, 337 F.Supp. 246, 248 (1971) (court held that shoes delivered to wholesaler six to nine months prior to their attempted return failed to reject or return the shoes within a reasonable time after their delivery and seasonably notify plaintiff of the defects in the shoes within a reasonable time). It failed to do so in this case, and the rejection was simply out of time.

B. *COUNT 1*

Count 1 of plaintiff's complaint alleges breach of contract. To the extent that Count 1 differs from Counts 3 and 4, this court finds that defendant Sylvania did *not* breach its contract — its agreement — with Knapp. As stated above, based on the credible evidence, this court finds, as a matter of fact, that by their express negotiations, by their express understandings, by their demonstrated conduct, and by their express course of dealings, Sylvania promised Knapp that, in the event that shoes were defectively manufactured, Knapp's remedy, and *sole* remedy, would be the replacement of [or credit for] those shoes shown to be defective and returned — nothing more, and nothing less. To that end, defendant lived up to its part of the bargain,[44] and plaintiff has failed to establish a breach of contract.

To the extent that plaintiff, by and through Count 1, raises those same claims set forth in Counts 3 and 4, what has been said above with respect to Counts 3 and 4 applies equally to the breach of contract claim subsumed under Count 1.

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[44] During the course of the interlocutory appeal, the United States Court of Appeals for the First Circuit indicated that the defendant had waived the affirmative defense of limitations of remedies under the Uniform Commercial Code.

That holding does not bear on the breach of contract claim. In this context, the matter is not whether the defendant may assert an affirmative defense of limitations of remedies. The sole question is whether defendant failed to live up to its bargain. And, on that score, plaintiff has failed to establish by a preponderance of the evidence that it did not.

C. *COUNTS 2, 5, 6, 7, and 8*

Plaintiff has failed to establish by a preponderance of the evidence any of those claims set forth in Count 2 (Breach of Express Warranties), Count 5 (Duty of Good Faith and Fair Dealing), Count 6 (Common Law Fraud), Count 7 (Common Law Negligent Misrepresentation), and Count 9 (Unfair and Deceptive Practices within the Meaning of Mass. Gen. Laws, Chapter 93A, § 11) for the reasons set forth in the Memorandum and Order (# 55) of this court dated January 11, 1991, and for the reasons set forth by the Massachusetts Supreme Judicial Court in its opinion dated October 13, 1994. *Knapp Shoes, Inc.* v. *Sylvania Shoe Manufacturing Corporation*, 418 Mass. 237, 640 N.E.2d 1101 (1994).[45]

Defendant's Claims

A. *Count 1: Breach of Contract for Goods Sold and Delivered*

Pursuant to M.G.L. c. 106, § 2-709(1)(a), Sylvania seeks to recover for goods sold and delivered to, and accepted by Knapp.

Section 2-709(1)(a) provides that the seller may recover the contract price with respect to accepted goods, as to which there has not been any rightful revocation of acceptance. *Akron Brick & Block Co.* v. *Moniz Engineering Co., Inc.*, 310 N.E.2d

[45] In the January 31, 1991, Memorandum and Order (# 55), this court addressed the c. 93A claim only insofar as plaintiff contended that defendant engaged in traditional unfair and deceptive practices — excluding a claim based upon an alleged violation of the Attorney General's regulations defining "unfair and deceptive" practices.

As this court reads the opinion in *Knapp Shoes, Inc.* v. *Sylvania Shoe Manufacturing Corporation*, 418 Mass. 237, 640 N.E.2d 1101 (1994), a mere showing of a breach of warranty in the circumstances of this case, *i.e.*, as between merchants, does not make out a violation of c. 93A.

128, 130 (Mass. 1974) (held where buyer accepted goods and did not properly revoke acceptance, seller would be entitled to recover unpaid portion of price).

Inasmuch as this court has concluded that Knapp's May 1990 revocation of acceptance of all goods accepted and remaining in its inventory was ineffective, it is clear that Knapp is liable under M.G.L. c. 106, § 2-709(1)(a) for the outstanding balance of shoes which Sylvania delivered to, and accepted by, Knapp which were not shown to be actually defective.[46]

B. *Count 2: Unjust Enrichment*

Count 2 of defendant's counterclaim sounds in unjust enrichment to the extent that plaintiff accepted shoes now shown to be defective for which defendant has not been paid.

Inasmuch as this court has determined that defendant is entitled to the contract price for those shoes as set forth in the paragraph immediately above, defendant has not shown that it is also entitled to recover for unjust enrichment.

C. *Count 3: Breach of Contract for Goods Manufactured and Not Reasonably Resalable.*

Pursuant to M.G.L. c. 106, § 2-709(1)(b), Sylvania seeks to recover the contract price for the goods manufactured or in the process of manufacture — *i.e.*, those shoes manufactured (or in the process of being manufactured) pursuant to orders entered by Knapp but which were not delivered. In the circumstances, this court finds and concludes that defendant has not carried its burden on this count for failure to satisfy the provisions of M.G.L. c. 106, § 2-709(b).

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[46] Computation of damages — for plaintiff and defendant — is set forth *infra*.

Section 2-709(1)(b) provides that a seller may recover the price of goods identified in the contract, *provided* that the seller is unable after reasonable effort to resell them at a reasonable price or if the circumstances reasonably indicate that such effort will be unavailing.[47]

Comment 3 of § 2-709 prescribes an "objective test" in determining whether goods are reasonably resalable. Pearlstein's letter dated June 7, 1990 (Ex. B) indicates that not only was such a resale practical, but went even further, writing ". . . your breach of contract will leave me no choice but to finish manufacturing the shoes you requested and resell all the shoes in my factory." *Id.*

While Pearlstein did assert that he would have to resell the shoes at a lower price because the shoes were already marked with a Knapp logo (Ex. B), Sylvania has failed to present any evidence — much less sufficient evidence — demonstrating that it attempted to resell the repudiated goods, or that such a sale was otherwise impractical under the circumstances, as was and is required by § 2-709(1)(b); *see Ludwig, Inc.* v. *Tobey*, 28 Mass. App. Ct. Dec. 6 (1964) (evidence sustained finding of trial court that reasonable effort to resell fur coat at a reasonable price would be unavailing where coat which buyer refused to accept was of petite size and alterations made for buyer made coat smaller).

In these circumstances, for want of any proof that defendant was unable to sell those shoes, this court finds and concludes that defendant is not entitled to the contract price under § 2-709.

Sylvania alleges alternatively that, if § 2-709(1)(b) does not apply, then it is entitled to damages under M.G.L. c. 106, § 2-708(1).

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[47] For purposes of Count 3 of defendant's counterclaim, this court assumes — without deciding — that plaintiff's repudiation of these identified shoes was ineffective.

Section 2-708(1) provides that damages for wrongful repudiation equal the differences between the market price at the time and place for tender and the unpaid contract price. *Charles Street Garage Co.* v. *Kaplan*, 45 N.E.2d 928 (Mass. 1942); *see Cesco Mfg. Corp.* v. *Norcross, Inc.*, 391 N.E.2d 270 (Mass. App. Ct. 1979) (although there was a market for fixtures which buyer refused to purchase, evidence showed the price was insufficient to justify the costs of finding the market, therefore seller could not be expected to do so and was entitled to recover it lost profit).

On this score, however, defendant asks this court to wholly speculate as to the appropriate measure of damages. As indicated immediately above, this court is unable to find any explanation — much less an adequate explanation — for Sylvania's failure to resell (or attempt to resell) the shoes it had manufactured or was in the process of manufacturing.

Again, according to Pearlstein's letter of June 7, 1990 (Ex. B), a market did indeed exist. Beyond Sylvania's failure to mitigate, there remains the question of reasonable calculation of damages under § 2-708(1).

Considering that the goods were not resold, § 2-708(1) provides reduction of recovery by what would have been received had there been a sale. And therein lies the rub in terms of burden of proof. No showing has been made as to what the market value for shoes bearing the Knapp logo was at the time and place of tender. While M.G.L. c. 106, § 2-723(2) grants a court reasonable discretion in receiving evidence of other comparable markets for the purpose of calculating damages, Sylvania failed to produce any evidence whatsoever that would assist this court in that regard. In these circumstances, an award of damages on Count 3 would be based on pure speculation, and is not permitted under controlling law. *Hendricks & Associates, Inc.* v. *Daewoo Corp.*, 923 F.2d 209 (Mass.

1991) (Massachusetts law permitted an award for prospective profits as the natural consequence of the breach *unless* the extent of the loss has not been evidenced with a fair degree of certainty); *Rambola* v. *Cosindas*, 220 N.E.2d 919 (Mass. 1966) (held loss of profits too conjectural, in determining prospective damages to be awarded, mathematical accuracy of proof is not required, but likelihood of profits may be proved by established earnings record and expert opinion may be introduced to substantiate amount of prospective profits). *Cf. Ondine Shipping Corp.* v. *Cataldo*, 24 F.3d 353, 355 (1st Cir. 1994).

D. *Count 4: Violation of M.G.L. c. 93A*

Not unlike plaintiff, defendant also contends that the conduct of plaintiff constituted unfair business dealings within the meaning of M.G.L. c. 93A.

On that score, defendant has failed to satisfy this court by a preponderance of the evidence that plaintiff engaged in unfair or deceptive conduct which warrants an award of double or treble damages.

Not ever conceivable business tort, breach of contract, or breach of warranty gives rise to a c. 93A claim. As the United States Court of Appeals for this Circuit has observed (*Quaker State Oil Refining Corporation* v. *Garrity Oil Company, Inc.*, 884 F.2d 1510, 1513 (1st Cir. 1989)) —

> Litigation under Mass. Gen. L. c. 93A is rampant, but a common refrain has developed. "The objectionable conduct must attain a level of rascality that would raise an eyebrow of someone inured to the rough and tumble world of commerce." *Levings* v. *Forbes & Wallace, Inc.*, 8 Mass. App. Ct. 498, 396 N.E.2d 149, 153 (1979); *see also Gooley* v. *Mobil*

Oil Corp., 851 F.2d 513, 515-16 (1st Cir. 1988) (unscrupulous or unethical conduct usually required); *Williams* v. *Arndt*, 626 F.Supp. 571, 581-82 (D. Mass. 1985) (similar). In other words, a chapter 93A claimant must show that the defendant's actions fell "within at least the penumbra of some common-law, statutory, or other established concept of unfairness," or were "immoral, unethical, oppressive or unscrupulous," and resulted in "substantial injury . . . to competitors or other businessmen." *PMP Associates, Inc.* v. *Globe Newspaper Co.*, 366 Mass. 593, 321 N.E.2d 915, 917 (1975); *accord Pepsi-Cola Metro. Bottling Co.* v. *Checkers, Inc.*, 754 F.2d 10, 17-18 (1st Cir. 1985); *Levings*, 396 N.E.2d at 153.[48]

On the state of the record before this court, defendant has simply fallen far short of establishing that the plaintiff engaged in the immoral, unethical, oppressive or unscrupulous conduct contemplated by c. 93A.[49]

DAMAGES

I. *KNAPP*

A. *Remaining Inventory*

Insofar as Knapp seeks to recover damages for those shoes currently in its inventory, its case mirrors the take-no-prisoners

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[48] In *Quaker State Oil*, the appellant contended that a refusal to pay off trade debts and promissory notes, coupled with a prosecution of counterclaim when the promisee brought suit to recover those trade debts and monies due and owing on the promissory notes, was a sort of "extortion" within the meaning of c. 93A. The Court of Appeals, in the circumstances, held that it was not.

[49] Indeed, in its Requested Findings of Fact and Conclusions of Law (# 140) and its Amended Request for Findings of Fact and Conclusions of Law (# 166), defendant Sylvania did not even address the matter of liability under c. 93A. To the extent that Sylvania's failure to do so did not constitute a waiver of Count 4, it clearly indicates that it can point to no set of facts establishing such liability.

approach proffered in support of its liability theories. That is to say, Knapp contends that its entire inventory of some 27,055 shoes manufactured by Sylvania is not merchantable, and that it is accordingly entitled to damages in the amount of $639,467.70.[50]

In the circumstances, this court finds that the relevant facts — as found and determined by this court — do not square with Knapp's major premise. To the extent that Knapp contends that it is entitled to revoke acceptance of all Sylvania manufactured shoes currently remaining in its inventory, this court has already concluded to the contrary. And to the extent that Knapp means to say that 100% (or even 40% to 60%)[51] of the Sylvania manufactured shoes were and are defective, Knapp has fallen far short of establishing by a preponderance of the evidence that that is the case.

This all or nothing approach proffered by Knapp[52] leaves open the matter of damages for those shoes currently remaining

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[50] Specifically, Knapp says (Proposed Findings of Fact and Conclusions of Law of Plaintiff Knapp Shoes, Inc. [# 139, paragraph 2691]:

> Knapp's entire inventory of 27,055 Sylvania shoes is not merchantable. None of these shoes can be shipped without concern that a large percentage (40-60% or more) will fail and further damage Knapp's reputation. The cost of this inventory to Knapp was $639,467.70. That calculation was made by Sebastaio, who analyzed each invoice from Sylvania to determine the number of pairs still in inventory and their cost. The cost excludes any freight or handling charges. The calculation is based on Knapp's first-in/first-out ("FIFO") inventory system.

[51] Knapp suggests that to continue to distribute the shoes would "further damage Knapp's reputation." There was no credible proof, however, that Knapp's reputation was, in fact, damaged, or would be damaged. All of its customers were well aware that the shoes were manufactured by Sylvania, and that the defects, if any, could be laid upon Sylvania's doorstep. Despite the reported defects — cured by Knapp — its customers continued to do business with Knapp, and none indicated that it was dissatisfied with Knapp's reputation.

[52] On this score, Sylvania has provided no assistance. For, just as Knapp contends that it is entitled to "all," Sylvania contends that Knapp is entitled to "nothing." Neither party has briefed the issue in terms of any middle ground.

in its inventory.[53] It might well be argued that Knapp should recover nothing for the remaining shoes in inventory, since the burden in the first instance rests on Knapp to show with some degree of certainty — something more than simply introducing into evidence hundreds of invoices and nothing more. But that approach blinks reality, since even Sylvania has acknowledged, before and after the institution of this lawsuit, that a certain percentage of the shoes sold to Knapp were, indeed, defective.

That being the case, and the parties — for whatever reason — choosing to leave this court to its own resources, damages for those Sylvania manufactured shoes remaining in inventory were calculated in the following manner:

First, this court, based on the invoices introduced into evidence (Plaintiff's Exhibit 81), found that 299,810 pairs of shoes were sold to Knapp by Sylvania during the course of the contract period.

Second, this court, again using the relevant invoices (Plaintiff's Exhibit 81), segregated, by style number, those shoes sold over the course of the contract period which are alleged to be defective. *See* Appendix A to this Memorandum of Findings and Conclusions, Columns A and B.[54]

Third, this court determined the percentage, for each style number, of the total shoes delivered over the contract period. Each style number's percentage was determined by dividing

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[53] This court accepts as true Knapp's assertion that 27,055 Sylvania manufactured shoes remain in its inventory.

[54] The segregated styles did *not* include any styles not alleged to be defective in Plaintiff's Exhibit 14. Moreover, the segregated styles did *not* include styles 2810, 2930, and 2940, inasmuch as plaintiff has failed to satisfy this court that the defective shoes within those style numbers were manufactured by Sylvania — and not by offshore manufacturers. (*See* paragraphs 39 through 43, 45 through 47, pp. 12-13, above).

the number of shoes in each style number (Column B) by the total number of shoes sold (299,810) over the contract period. That percentage is set forth in Column C of Appendix A to this Memorandum of Findings and Conclusions.

Fourth, this court next estimated the number of shoes, again by style number, remaining in the inventory. For want of any proof one way or the other — this court concluded that the shoes remaining in inventory (27,055)[55] were proportional to all of the shoes sold over the course of the contract. In determining the number of shoes for each style number remaining in the inventory, this court multiplied the percent of shoes sold over the contract period for each style number (Column C), times the total inventory (27,055), resulting in the number of shoes by style number in the inventory (Column D) of Appendix A to this Memorandum of Findings and Conclusions.

Fifth, this court, based on the only credible indicator of the number of defects inherent in the various style shoes — the actual return rate as reflected in Defendant's Exhibit J — determined the historical defect rate of each style shoe (Column E of Appendix A to this Memorandum of Findings and Conclusions).

Sixth, this court determined the number of defective shoes for each style by multiplying the defective rate (Column E of Appendix A to this Memorandum of Findings and Conclusions) times the estimated number of that shoe style currently in inventory (Column D of Appendix A to this Memorandum of Findings and Conclusions) — resulting in the number of defects by style number as shown in Column F of Appendix A to this Memorandum of Findings and Conclusions.

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[55] *See* note 53 *supra*.

Seventh, this court, again from the relevant invoices (Plaintiff Exhibit 81), determined the *average*[56] price of each style sold over the course of the contract period — each average price being set forth in Column G of Appendix A to this Memorandum of Findings and Conclusions.

Eighth, based on this information, this court determined the average defect damages, again by style number, by multiplying the number of defects by style number (Column F of Appendix A to this Memorandum of Findings and Conclusions), by the average price per pair, Column G of Appendix A to this Memorandum of Findings and Conclusions.

Based on these findings, this court finds and concludes that, based on the only credible evidence, in terms of damages for shoes currently remaining in its inventory, Knapp is entitled to damages in the amount of $24,525.32, nothing more, and nothing less.

B. *Unresolved Credits*

Based on the credible evidence, this court finds and concludes that, in terms of credits for defective shoes previously returns to Sylvania, Knapp is, consistent with its proposed finding (Proposed Findings of Fact and Conclusions of Law of Plaintiff Knapp Shoes, Inc. [# 139, paragraph 268]), entitled to damages in the amount of $92,472.97.

C. *Incidental Damages*

Plaintiff has failed to satisfy this court by a preponderance of the evidence that it is entitled to the item referred to in paragraph 271 of the Proposed Findings of Fact and Conclusions of Law of Plaintiff Knapp Shoes, Inc. (# 139]. In that

[56]This court — for want of any other reasonable suggestion by the parties — chose the *average* price.

proposed finding, plaintiff says that it issued a credit of $64,797.65 to Federal Express for defective style 2600 shoes.

While this court does not gainsay that that credit was issued,[57] plaintiff has failed to satisfy this court that it is not, in a very real sense, double-counting. The credit was issued to Federal Express for defective shoes. Sylvania, on the other hand, was routinely issuing credits (or replacements) for defective shoes returned to it pursuant to their ongoing understanding. Indeed, some 4,305 pairs of style 2600 were returned and replaced (or otherwise creditor for) during the course of the contract period. *See* Defendant's Exhibit J. Plaintiff has not satisfied this court by a preponderance of the evidence that the credit which it issued to Federal Express was not satisfied by Sylvania.

As to the remaining claims for incidental damages, based on the credible evidence,[58] this court finds and concludes that, for incident damages — *i.e.*, those damages referred to in paragraphs 272 through 279 of the Proposed Findings of Fact and Conclusions of Law of Plaintiff Shoes, Inc. [# 139] — Knapp is entitled to incidental damages, but only in the amount of $43,064.45, since this court finds and concludes that plaintiff's claims for storage costs, in the circumstances so found by this court above, are excessive.[59]

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[57] Defendant contends (Defendant Sylvania Shoes Manufacturing Corporation's Amended Request for Findings of Fact and Rulings of Law on the Issue of Damages [# 166, pp. 4-6, paragraphs 10 through 12]) that plaintiff relies on hearsay evidence on this aspect, as well as it relates to Plaintiff's Proposed Finding 274.

In support of that suggestion, defendant points to a ruling made by this court during the course of the liability phase of the trial. But that ruling was limited to the evidence then and there presented — not to the later testimony of Sebastiao (and Plaintiff's Exhibits 95 and 96 received) during the damages phase of the trial.

[58] *See* note 57 above.

[59] In Proposed Finding 279, Knapp contends that it incurred storage charges for the defective shoes — *i.e.*, $.02/pair per month — for all of the 27,055 shoes.

Consistent with the findings set forth above, however, this court finds that Knapp is entitled to such costs only for those shoes shown to be defective — *i.e.*, Knapp is *not* entitled to storage costs for non-defective shoes.

D. *Lost Profits Through the Date of the Filing of the Lawsuit*

Plaintiff contends that it is entitled damages in the amount of $436,311.80 for lost profits *vis a vis* the defective shoes remaining in the Knapp inventory.[60]

In this court's view, Knapp is entitled to nothing.

First, even assuming the premises of the contention,[61] insofar as Knapp says that it is entitled to $426,311.80, Knapp is simply wrong as a mathematical matter.[62] At best, a 40% profit margin on the $639,467.70 amount of shoes remaining in inventory would be $255,787.08.[63]

Second, plaintiff's contentions are bottomed on unproven premises. At best, only 1,013 (Column F of Appendix A to the Memorandum of Findings and Conclusions) of the shoes remaining in inventory were defective. And, given the fact that some 26,042 non-defective shoes of all styles remained in inventory, plaintiff has failed to satisfy this court by any

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Since the credible evidence only shows that, at most, 1013 (the sum of column F) defective shoes remained in Knapp's inventory, Knapp is entitled only to $283.64 for storage charges ((1013 / 27,055)* $7,575.40).

[60] Specifically, Knapp says (Proposed Findings of Fact and Conclusions of Law of Plaintiff Knapp Shoes, Inc. [# 139, paragraph 270]):

> Knapp historically has averaged profit margins in the industrial division of between 35 to 55 percent. Knapp earned a 40% profit margin on sales to its largest customers — Hilton and Federal Express. Thus, Sebastiao used a 40% margin and calculated that Knapp would have earned $426,311.80 on the shoes in its inventory had they been saleable.

[61] That all of the 27,055 shoes remaining in inventory were defective, that those shoes had a total cost of $639,467.70, and that Knapp enjoyed a historical profit margin of 40%.

[62] Sebastiao, of Knapp, testified (10 Tr. 14-88) as to his calculation of lost profits for those shoes remaining in inventory, and those calculations also appear on Plaintiff's Exhibit 94.

[63] Unless the term profit margin has a special meaning not further alluded to in the plaintiff's evidence, this court understands the term profit margin to be simply a mathematical projection (.40* $639,467.70), which, cut any way, will always be $255,787.08.

evidence — much less a preponderance of the evidence — that Knapp failed to reap any profit on account of the, at best, 1,013 shoes shown to be defective within inventory. Accordingly, plaintiff is entitled to nothing for lost profits *vis a vis* the defective shoes remaining in the Knapp inventory.

E. *Loss of Future Profits*

Knapp contends that, because of the defective shoes sold to it by Sylvania, it is entitled to damages for lost *future* profits in the amount of $2,895,326 (paragraphs 282 through 295 of the Proposed Findings of Fact and Conclusions of Law of Plaintiff Knapp Shoes, Inc. [# 139]).[64]

Although Knapp presented evidence in the nature of expert testimony on this matter, that expert testimony consisted of little more than "number-crunching," and was based on assumed premises which this court finds not to have been proved by a preponderance of the evidence.

First, the conclusion of the expert assumes, without any meaningful elaboration, that the sort of shoe program for which the shoes were manufactured had assumed a life of its own, and would continue unabated, if not escalating, for a period of five years. There as been no credible evidence, however, which supports that premise.

That program was initiated at a time when the economy was enjoying an upswing, at a time when businesses were willing and able to assume the costs of those shoes on behalf of its employees. But plaintiff has failed to show that that largesse would, more likely than not, continue; to the contrary, the only record evidence on this score shows that at least one company chose to terminate the safety shoe program, not only

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[64] The present value of those lost future profits to and through 1995.

because of "on-going quality problems," but also because of "costs and general administration of the program[,]" (Defendant's Exhibit RR), and yet another, Federal Express, a major account, drastically cut back on its purchasing program by changing the nature of the manner in which it subsidized its employees, and its manner of billing. (Taylor, 15-54, 55, 56).[65] Nothing in the factual record before this court shows that those programs, experimenting, as they were, in the new look, would have continued — much less at the profit opined by plaintiff's expert.

Secondly, plaintiff's expert made nothing of the fact that Knapp's overall financial picture, including shortage of capital, deteriorated significantly since the program had been commenced. It is clear, however, that an inability to deliver is as much influenced by the financial strength of a company as other factors.

Thirdly, the expert testimony, once again, mirrored the consistent "all" theme of the plaintiff throughout the trial — *i.e.*, that 100% of the shoes delivered[66] were defective. The expert's opinion failed to even attempt to suggest any particularized causation. He simply said that, since "all" of the goods were defective, "all" future profits were caused by the breach of the defendant. Inasmuch as this court finds that that premise is not supported by the evidence and law, this court cannot fairly find that any profits — much less the $2,895,326 suggested by plaintiff — were caused by the breach of the defendant. To this extent, plaintiff's claim is clearly speculative.

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[65] Additionally, although Knapp was originally the sole vendor to Federal Express for all shoes, that arrangement changed in or about 1988, when Federal Express was serviced by two additional vendors. (Taylor, 15-54, 55, 56).

[66] Even on this point, plaintiff's evidence is, at best, contradictory. On the one hand, plaintiff proffered by way of testimony that *all* of the inventory was defective; yet, on the other, plaintiff suggests (Proposed Findings of Fact and Conclusions of Law of Plaintiff Knapp Shoes, Inc. [# 139, paragraph 269]) that "40-60% of more" of the shoes were defective.

Lastly, and related to the point made immediately above, plaintiff has made no showing whatsoever that it attempted to mitigate its damage in terms of lost profits.

Although plaintiff alludes in general terms to the law (Proposed Findings of Fact and Conclusions of Law of Plaintiff Knapp Shoes, Inc. [# 139, paragraphs 332-33]), it is but a passing allusion.

To be sure, lost profits, including lost future profits, are recoverable, for breaches of warranty. M.G.L. c. 106, § 2-715. But the remedy provided has its own limitations. Section 2-715 provides for "any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know *and which could not reasonably be prevented by cover or otherwise*." (Emphasis added). On the latter point, the Draftsman's Comments indicate —

> Subparagraph (2) carries forward the provisions of the prior uniform statutory provision as to consequential damages resulting from breach of warranty, *but modifies the rule by requiring first that the buyer attempt to minimize his damages in good faith, either by cover or otherwise*. (Emphasis added).

The comments of the drafters is clearly consistent with governing law. *See, e.g., Barry & Sewall Indus. Supply* v. *Metal-Prep*, 912 F.2d 252, 259-60 (8th Cir. 1990); *Hilord Chemical Corp.* v. *Ricoh Electronics, Inc.*, 875 F.2d 32, 38-39 (2d Cir. 1989);[67] *Cancun Adventure Tours* v. *Underwater Designer Co.*, 862 F.2d 1044, 1049 (4th Cir. 1988).

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[67] There that court observed (*id.*) —

> New York's Uniform Commercial Code, N.Y.U.C.C. § 2715(2)(a) requires a buyer to *seek* a covering contract as a *predicate* to recovering lost profits. *See Happy Dack Trading Co., Ltd.* v. *Agro-Industries, Inc.*, 602 F.Supp. 986, 994 (S.D.N.Y. 1984); *cf.* N.Y.U.C.C. § 2-712(3) Official Comment (recovery of consequential damages is limited to damages which could not have been obviated by cover).

That showing — *i.e.*, that Knapp, in good faith, attempted to minimize its damage (in this instance, minimize its loss of future profits) is simply non-existent.

For one thing, the record evidence shows that Knapp could have "minimized" its supposed lost profits simply by continuing its ongoing relationship with Sylvania. To be sure, there were some proven defects. But not remotely in the degree suggested by Knapp, and it is reasonable for this court to conclude that its alleged lost profits clearly could have been minimized by simply continuing its relationship with Sylvania — not the triggering of a lawsuit.

Moreover, at the time Knapp purported to revoke acceptance of all shoes previously accepted — indeed, even before — Knapp was exploring a new offshore source for the same style shoes. *See* paragraph 65, page 18, above. The evidence clearly shows that viable alternatives to cover existed; more to the point, the evidence presented by plaintiff is simply barren of any indication that it made any reasonable effort whatsoever "to *seek* a covering contract as a *predicate* to recovering lost profits." *Hilord Chemical Corp.* v. *Richo Electronics, Inc.*, *supra*, and note 67 above.

This court accordingly concludes that Knapp — mistakenly insisting throughout that it was entitled to undo entirely that which had been done over the course of the years — was entitled to profit therefrom (here in the form of allegedly lost future profits) to the handsome tune of close to $3 million. Knapp is as wrong on the facts as it was short on the law. Knapp is entitled to nothing in terms of allegedly lost profits.[68]

This court has no reason to believe that the Massachusetts courts (given that this is a diversity case) would construe the import of Section 2-715(2)(a) differently from all the other courts which have construed that section of the Uniform Commercial Code.

[68] As recently observed by the United States Court of Appeals for this Circuit (*Ondine Shipping Corp.* v. *Cataldo*, 24 F.3d 353, 356 (1st Cir. 1994)) —

II. SYLVANIA

For the reasons set forth above, paragraphs D.1-D.4, pp. 39-45, above, defendant, on its counterclaim, is entitled to damages as to Count 1, but not as to Counts 2 through 4.

On Count 1, pursuant to M.G.L. c. 106, § 2-709(1)(a), Sylvania seeks to recover for goods sold and delivered to Knapp.

M.G.L. c. 106, § 2-709(1)(a), provides that the seller may recover the contract price with respect to accepted goods, as to which there has not been any rightful revocation of acceptance. *Akron Brick & Block Co.* v. *Moniz Engineering Co., Inc.*, 310 N.E.2d 128, 130 (Mass. 1974) (held where buyer accepted goods and did not properly revoke acceptance, seller would be entitled to recover unpaid portion of price).

Since Knapp's May 1990 revocation of acceptance was ineffective, Knapp is liable under M.G.L. c. 106, § 2-709(1)(a) for the outstanding balance of shoes which Sylvania delivered to Knapp.

Sylvania's credited testimony on this issue established this to equal $223,626.47.[69] (Pearlstein, 9-15, Ex. II).

CONCLUSION

Based on the foregoing, and the rulings set forth in the Memorandum and Order (# 55) of this court dated January 31, 1991, judgment shall enter as follows:

We do not think that justice miscarries when a court rebuffs a suitor's efforts to obtain clearly excessive damages on an insupportable legal theory and leaves the suitor holding an empty (or near-empty) bag. *Cf. Quinones-Pacheco* v. *American Airlines, Inc.*, 979 F.2d 1, 6 (1st Cir. 1992) (upholding take-nothing verdict when plaintiffs failed to prove their damages). Overreaching, like virtue, is often its own reward.

[69] Pursuant to this court's determination that Knapp is entitled to recover in Count 1, for breach of contract for goods sold and delivered, Count 2, which claims damages for unjust enrichment for shoes delivered and accepted, is rendered moot.

Plaintiff's Claims

Count 1 — Judgment for the defendant and against the plaintiff;

Count 1 — Judgment for the defendant and against the plaintiff;

Counts 2, 5, 6, 7 and 8 — Judgment for the defendant and against the plaintiff;

Counts 3 and 4 — Judgment for the plaintiff and against the defendant in the amount of $160,062.74;

Count 9 — Judgment for the plaintiff to the extent that the rights and obligations of the respective parties are as set forth in this Memorandum of Findings and Conclusions;

Count 10 — Judgment against the plaintiff on the grounds that the relief sought is now moot;

Count 11 — Judgment against the plaintiff on the grounds that the relief sought is now moot.

Defendant's Counterclaims

Count 1 — Judgment for the defendant and against the plaintiff in the amount of $223,626.47;

Counts 2, 3 and 4 — Judgment for the plaintiff and against the defendant.

The orders granting a temporary restraining order (as later amended, in part) and the issuance of trustee process, entered on May 31, 1991, are hereby ordered vacated and dissolved.

/s/_____
UNITED STATES MAGISTRATE COURT

	A	B	C	D
1		All Shoes Sold Over Contract Per		
2		Invoices (Pl. Ex. 81) = 299,810		
3				
4		Total Number	Percentage of Total	Number of Shoes
5		of Shoes Sold	Shoes Delivered Over	Per Style Number
6	Style No.	Over Contract Period	Contract Period	in Inventory
7	1244	6000	2.00%	541
8	1245	1692	0.56%	153
9	1251	24936	8.32%	2250
10	1257	3024	1.01%	273
11	2600	56745	18.93%	5121
12	2601	13464	4.49%	1215
13	2605	16525	5.51%	1491
14	2660	26352	8.79%	2378
15	2665	29110	9.71%	2627
16	2670	10531	3.51%	950
17	2675	7697	2.57%	695
18	2814	2016	0.67%	182
19	2815	3876	1.29%	350
20	2816	3672	1.22%	331
21	2840	15026	5.01%	1356
22	2845	6336	2.11%	572
23	2916	1872	0.62%	169
24	2935	8087	2.70%	730
25	2950	3960	1.32%	357
26	**TOTALS**			

E	F	G	H
Total Shoes Claimed By Plaintiff To Be			
Currently In Inventory = 27,055			
	Number of		Average Defect
	Defects	Average Price	Cost
Defective Rate	Per Style No.	Per Pair	Per Style No.
3.70%	20.03	$18.20	$364.61
3.20%	4.89	$23.75	$116.04
2.80%	63.01	$21.65	$1,364.09
4.10%	11.19	$26.25	$293.69
7.80%	399.41	$24.25	$9,685.80
8.90%	108.13	$25.75	$2,784.47
6.60%	98.42	$26.75	$2,632.76
1.00%	2378	$23.25	$552.89
2.50%	65.67	$22.00	$1,444.80
1.00%	9.50	$27.90	$265.14
1.20%	8.33	$27.90	$232.55
1.00%	1.82	$18.75	$34.11
19.00%	66.46	$22.10	$1,468.69
1.30%	4.31	$22.10	$95.20
2.30%	31.19	$27.40	$854.52
9.50%	54.32	$27.30	$1,482.87
0.26%	0.44	$18.75	$8.24
5.40%	39.41	$19.90	$784.22
0.80%	2.86	$21.25	$60.75
			$24,525.43

APPENDIX C

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

Civil Action No.
90-10916-Y

KNAPP SHOES, INC.,
PLAINTIFF,

v.

SYLVANIA SHOE MANUFACTURING CORPORATION,
DEFENDANT.

JUDGMENT

March 1, 1995

COHEN, M.J.

The above-entitled case having been tried to this court without a jury with the consent of the parties pursuant to the provisions of 28 U.S.C. § 636(c) and Rule 4(c) of the Rules for United States Magistrates in the United States District Court for the District of Massachusetts, for the reasons set forth in the Memorandum of Findings and Conclusions entered contemporaneously herewith, and for the reasons set forth in the Memorandum and Order (# 55) of this court dated January 31, 1991:

As To Plaintiff's Claims

Count 1 — Judgment for the defendant and against the plaintiff;

Counts 2, 5, 6, 7 and 8 — Judgment for the defendant and against the plaintiff;

Counts 3 and 4 — Judgment for the plaintiff and against the defendant in the amount of $160,062.74.

Count 9 — Judgment for the plaintiff to the extent that the rights and obligations of the respective parties are as set forth in this Memorandum of Findings and Conclusions.

Count 10 — Judgment against the plaintiff on the grounds that the relief sought is now moot;

Count 11 — Judgment against the plaintiff on the grounds that the relief sought is now moot.

As to Defendant's Counterclaims

Count 1 — Judgment for the defendant and against the plaintiff in the amount of $223,626.47;

Counts 2, 3 and 4 — Judgment for the plaintiff and against the defendant.

The orders granting a temporary restraining order (as later amended, in part) and the issuance of trustee process, entered on May 31, 1991, are hereby ordered vacated and dissolved.

Each party shall bear its own costs.

/s/_____

UNITED STATES MAGISTRATE JUDGE

APPENDIX D

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

Civil Action No.
90-10916-WGY

KNAPP SHOES, INC.,
PLAINTIFF,

v.

SYLVANIA SHOE MANUFACTURING CORPORATION,
DEFENDANT.

AMENDED JUDGMENT

March 21, 1996

COHEN, M.J.

Consistent with the Order of Remand issued by the United States Court of Appeals for this Circuit, and consistent with the findings and conclusions entered this date in the Memorandum and Order on Costs and Prejudgment Interest entered contemporaneously herewith, this Amended Judgment represents the final judgment of this court.

The above-entitled case having been tried to this court without a jury with the consent of the parties pursuant to the provisions of 28 U.S.C. § 636(c) and Rule 4(c) of the Rules for United States Magistrates in the United States District Court for the District of Massachusetts.

As To Plaintiff's Claims

Count 1 — Judgment for the defendant and against the plaintiff;

Counts 2, 5, 6, 7 and 8 — Judgment for the defendant and against the plaintiff;

Counts 3 and 4 — Judgment for the plaintiff and against the defendant in the amount of $477,538.09.

Count 9 — Judgment for the plaintiff to the extent that the rights and obligations of the respective parties are as set forth in this Memorandum of Findings and Conclusions.

Count 10 — Judgment against the plaintiff on the grounds that the relief sought is now moot;

Count 11 — Judgment against the plaintiff on the grounds that the relief sought is now moot.

Plaintiff is hereby awarded prejudgment interest in the amount of $382,364.06.

As to Defendant's Counterclaims

Count 1 — Judgment for the defendant and against the plaintiff in the amount of $223,626.47;

Counts 2, 3 and 4 — Judgment for the plaintiff and against the defendant.

Defendant is hereby awarded prejudgment interest in the amount of $142,134.14.

The orders granting a temporary restraining order (as later amended, in part) and the issuance of trustee process, entered on May 31, 1991, are hereby ordered modified to the extent of $494,141.54, the net difference between the total award to the plaintiff and the total award to the defendant.

Costs are hereby ordered taxed in favor of the plaintiff and against the defendant in the amount of $29,335.74.[1]

/s/_____
UNITED STATES MAGISTRATE JUDGE

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 93-1527

KNAPP SHOES, INC.,
PLAINTIFF-APPELLANT,

v.

SYLVANIA SHOE MANUFACTURING CORPORATION,
DEFENDANT-APPELLEE.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS.
[HON. LAWRENCE P. COHEN, U.S. MAGISTRATE JUDGE]

Before
Breyer, *Chief Judge*,
Boudin and Stahl, *Circuit Judges*.

Timothy C. Blank with whom *Bernard J. Bonn III*, *Dina Warner* and *Dechert Price & Rhoads* were on brief for appellant.
Joseph B. Green with whom *Bennett H. Klein* and *Kotin, Crabtree & Strong* were on brief for appellee.

February 10, 1994

BOUDIN, *Circuit Judge*. Knapp Shoes, Inc., the plaintiff in this commercial dispute, appeals from the district court's order dissolving a preliminary injunction. That injunction had frozen assets of the defendant, Sylvania Shoe Manufacturing Corp., in an amount sufficient to satisfy a potential judgment in Knapp's favor. Because we find that the primary ground of the court's order is a defense that was waived by Sylvania, and that the court's findings were insufficient to support its action on the alternative ground urged by Sylvania, we vacate the order dissolving the preliminary injunction.

I.

Knapp sells work shoes at both the wholesale and retail levels, including a line of shoes with a patented slip-resistant rubber sole. Beginning in 1986 or 1987, Knapp placed orders with Sylvania for the latter to manufacture and supply Knapp with several different styles of shoes incorporating Knapp's slip-resistant sole. Knapp intended to resell the shoes both through its retail outlets and directly to large customers in the restaurant, hotel and other industries. Between 1987 and 1989, Sylvania manufactured and delivered over 250,000 pairs of shoes to Knapp.

Sometime in 1987, Knapp became concerned about the quality of the shoes manufactured by Sylvania. The primary problem was the tendency of the sole to separate from the leather body of the shoe. Although the parties disagreed (both then and now) as to the extent of the problem, Sylvania made a number of changes in construction of the shoes in order to eliminate the problem. According to its later complaint, Knapp was assured by Sylvania on various occasions between 1987 and 1989 that the sole adhesion problem had been remedied. These assurances, Knapp asserts, were untrue; it says that the proportion of defects remained high and in some periods approached 100% for certain styles.

On April 10, 1990, Knapp filed this diversity action under Massachusetts law for breach of contract (count 1), breach of express warranty and implied warranties of merchantability and fitness (counts 2-4), breach of the duty of good faith and fair dealing (count 5), fraud and negligent misrepresentation (counts 6 and 7), and violation of Mass. Gen. Laws Ann. c. 93A (count 8).[1] The gravamen of all these claims was that too many of the shoes manufactured by Sylvania and sold to Knapp were defective.

Knapp's complaint was quite detailed in setting forth the categories of damages it claimed to have suffered. These included increased costs of inspection and for handling and returning defective shoes; lost profits due to Knapp's inability to fill orders for customers; losses due to Sylvania's refusal to give credit for certain shoes that Knapp did return or attempted to return; increased costs because Knapp was forced to make substitute purchases from other manufacturers; credits and price concessions Knapp had to afford its own customers because of their dissatisfaction with defective orders; and losses in good will and in customer orders due to Sylvania's conduct.

Sylvania filed an answer and counterclaim. The answer denied virtually all of the incriminating allegations. It also asserted 13 affirmative defenses, including estoppel, disclaimer of warranties, unclean hands, laches and contributory negligence. Sylvania's counterclaim alleged that Knapp still owed Sylvania about $277,000 for shoe orders not yet paid (Sylvania also claimed multiple damages and attorney's fees under Chapter 93A). The counterclaim suggested that any defects were due to Knapp's own specification of materials to be used in manufacturing its shoes.

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[1] Chapter 93A outlaws "[u]nfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce." Mass. Gen. Laws Ann. c. 93A, § 2(a), and it permits awards of multiple damages and attorney's fees. *Id.* § 11.

Both parties consented to proceed before a magistrate judge and waived a jury trial. The trial was bifurcated, with the liability phase covering nine trial days in January 1991. At the conclusion of this phase, the magistrate judge on January 31, 1991, entered a four-page memorandum and order that devoted one paragraph each to five of Knapp's eight counts, without discussing Sylvania's counterclaim. The first substantive paragraph reads as follows:

> Except to the extent that plaintiff has shown, or can show, that shoes manufactured by defendant and delivered to plaintiff, and/or shoes manufactured by defendant to be delivered to plaintiff, were, in fact, defective, plaintiff has failed to satisfy this court by a preponderance of the evidence that defendant breached an express warranty. None of the parties anticipated, or could, in the circumstances, reasonably anticipate, that each and every shoe manufactured by defendant for the plaintiff would be free of defect. On its part, defendant expressly promised that it would use its best effort to produce a defect-free shoe, and that it would credit plaintiff's account for those defective shoes which plaintiff returned. All parties clearly understood that that was the extent of the express warranty, nothing more, and nothing less.

In the subsequent paragraphs, the magistrate judge found that Knapp had failed to prove fraud, negligent misrepresentation or — "except to the extent that plaintiff has shown, or can show," a refusal by Sylvania to credit returned defective shoes — breach of the duty of good faith and fair dealing. As for Knapp's c. 93a claim, the order said that Sylvania had not been shown to have engaged in conduct so unscrupulous as to make it liable for multiple damages; it noted, but did not

decide, the question whether attorney's fees might be due Knapp under c. 93A on the theory that a breach of warranty was a violation of c. 93A under a regulation of the state's attorney general.

In May 1991, prior to the damages phase of trial, Knapp discovered that Sylvania was going out of business and liquidating its assets. Fearful that Sylvania would soon be judgment-proof, Knapp obtained a temporary restraining order precluding Sylvania from dissipating assets in the amount of $3,775,657.22 — the amount of damages that Knapp hoped to prove in the next phase of the trial. The magistrate judge modified this order on June 10, 1991, converting it into a preliminary injunction and amending it to allow Sylvania to make limited payments to its creditors and lawyers.

The damages phase of trial took place over five days in June 1991; at Sylvania's behest, an additional day of evidence was heard on November 25, 1991. Proposed findings were filed by both sides in March 1992. It appears that nothing further occurred during the next 12 months until, in March 1993, the magistrate judge issued an order proposing to certify certain questions to the Massachusetts Supreme Judicial Court. Both sides opposed certification, but on April 8, 1993, the magistrate judge certified two questions to the Supreme Judicial Court; both related to the possible application of c. 93a to "a simple breach of warranty."[2]

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[2] The first question was whether a regulation issued by the state attorney general under c. 93A, defining a violation to include a breach of warranty, applied to a transaction of the kind described by the magistrate judge, namely, a breach as between two similarly situated businesses based on delivery of a "minute" portion of non-conforming goods. If the answer were yes, the second question asked whether the regulation was valid under the authorizing statute.

In the certification, the magistrate judge prefaced the two certified questions with a ten-page statement. The statement repeated the magistrate judge's rulings on the five counts discussed in its January 3, 1991, order, and then made several additional findings of fact and conclusions of law. These determinations were prefaced by a statement that "only the ultimate findings and conclusions are set forth herein — not the subsidiary findings and conclusions." The magistrate judge determined *inter alia* that:

> 1. . . . By their express negotiations, by their express understandings, and by their express course of dealings, Sylvania promised Knapp that, in the event that shoes were defectively manufactured, Knapp's remedy, and *sole* remedy, would be the replacement of [or credit for] those shoes shown to be defective and returned — nothing more, and nothing less [footnote omitted].
>
> 2. Because of this clear and express understanding between the respective parties, Knapp's *sole* remedies, in terms of breach of contract, or under the relevant provisions of the Uniform Commercial Code, are limited to the replacement of [or credit for] those shoes shown to be defective and returned to Sylvania.

Other determinations included a ruling that Sylvania was obliged to give a credit for or replace any defective shoes returned by Knapp; a statement that many of the shoes returned by Knapp's customers were made by an overseas supplier; a finding that Sylvania acted in "the utmost good faith" to correct a problem "not reasonably foreseen" by either side; and a finding in a final footnote that "at best . . . approximately

The Supreme Judicial Court has yet to act on the questions certified by the district court. But on the strength of the magistrate judge's findings in the certification order, Sylvania moved on April 8, 1993, to dissolve the preliminary injunction. The magistrate judge granted this motion on May 5, 1993, concluding that its earlier findings left Knapp with so little hope of substantial recovery that the freeze on Sylvania's assets could no longer be justified. The order set forth findings 1 and 2 from the certification, quoted in pertinent part above.

Knapp filed a notice of appeal on May 11, 1993, and this court stayed the magistrate judge's order dissolving the preliminary injunction pending the outcome of this appeal. We have jurisdiction pursuant to 28 U.S.C. § 1291(a)(1), which permits appeals from interlocutory orders dissolving injunctions.

II.

This circuit has not explicitly addressed the standard to be applied by a district court in deciding whether to dissolve a preliminary injunction. But we think it evident that in the ordinary case dissolution should depend on the same considerations that guide a judge in deciding whether to grant or deny a preliminary injunction in the first place. The familiar quartet includes likelihood of success, the threat of irreparable injury to the party seeking interim relief, the equities and the public interest.[3] It is not surprising that a fresh look after the trial evidence is in might produce a different judgment about the probability of success.

In dissolving the preliminary injunction in this case, the magistrate judge relied upon his certification findings that the

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[3] *See, e.g., Teradyne, Inc.* v. *Mostek Corp.*, 797 F.2d 43, 51 (1st Cir. 1986); *Planned Parenthood League of Massachusetts* v. *Bellotti*, 641 F.2d 1006, 1009 (1st Cir. 1981).

parties had agreed to limit their remedies under the contract to return and replacement or credit for defective shoes. As already noted, the magistrate judge concluded in finding number 1 that "[b]y their express negotiations, by their express understandings, and by their express course of dealings, Sylvania promised Knapp that, in the event that shoes were defectively manufactured, Knapp's remedy, and *sole* remedy, would be the replacement of [or credit for] those shoes shown to be defective and returned — nothing more, and nothing less."

Accordingly, the magistrate judge held that Knapp's claims for damages, *see* Mass. Gen. Laws Ann. c. 106, § 2-715 (buyer's ordinary damages), § 7-16 (incidental and consequential damages), over and above credits for shoes actually returned to Sylvania, were barred by Mass. Gen. Laws Ann. c. 106, § 2-719;[4] hence, Knapp's likelihood of substantial recovery was insufficient to support the preliminary injunction. We need not decide whether a section 2-719 defense was supported by the evidence, because we hold that Sylvania waived any such limitation of remedies defense by failing to raise it in a timely fashion.

Fed. R. Civ. P. 8(c) requires a party to affirmatively plead certain specified defenses, as well as "any other matter constituting an avoidance or affirmative defense." Affirmative defenses not so pleaded are waived. *See FDIC* v. *Ramirez-Rivera*, 869 F.2d 624, 626 (1st Cir. 1989). We have previously

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[4] Mass. Gen. Laws Ann. c. 106, § 2-719, pertinently provides:

> Contractual Modification or Limitation of Remedy
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> (1) . . . (a) the agreement may provide for remedies in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this article, as by limiting the buyer's remedies to return of the goods and repayment of non-conforming goods or parts; and
>
> (b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.

held that a statutory provision limiting damages to a fixed sum constituted an affirmative defense for purposes of Rule 8(c). *Jakobsen* v. *Massachusetts Port Authority*, 520 F.2d 810, 813 (1st Cir. 1975). Section 2-719 performs the same damage limitation function, and there is no reason to reach a contrary result here. *See also Ingraham* v. *United States*, 808 F.2d 1075, 1079 (5th Cir. 1987).

Sylvania failed to raise the defense in its answer, its amended answer, its pretrial memorandum, or its proposed jury instructions.[5] Indeed, there is no indication that either of the parties thought that a limitation of remedies issue was present in the case until the ninth and final day of the liability phase of trial. At that point, after all of the evidence had been submitted, the magistrate judge said "[w]e've got a problem, I think under § 719(b) of whether or not . . . the parties agreed that defective returns, credits for [*sic*] would be the sole remedy."

Sylvania does not dispute that the limitation of remedies is an affirmative defense. Nor does it suggest that it raised that defense in its answer or elsewhere. Instead, Sylvania argues that the statement of the magistrate judge at the close of the liability stage, as well as later ones made by the magistrate judge in the damages phase, put plaintiffs on notice as to the issue. We do not agree.

The reason why affirmative defenses under Rule 8(c) must be pled in the answer is to give the opposing party notice of the defense and a chance to develop evidence and offer arguments to controvert the defense. *Blonder-Tongue Laboratories, Inc.* v. *University of Illinois Foundation*, 402 U.S. 313, 350 (1971). Some courts have excused noncompliance with Rule 8(c) if "a plaintiff receives notice of an affirmative defense by

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[5] The parties submitted proposed jury instructions prior to their waiver of trial by jury and consent to proceed before the magistrate judge.

some means other than pleadings" and is not prejudiced by the omission of the defense from the initial pleading. *E.g.*, *Moore, Owen, Thomas & Co.* v. *Coffey*, 992 F.2d 1439, 1445 (6th Cir. 1993). This court reached the same result where a defense "has been fully tried under the express or implied consent of the parties, as if it had been raised in the original responsive pleading." *Ramirez-Rivera*, 869 F.2d at 626-27.

We need not decide whether notice and no prejudice would also serve as an excuse in this circuit, *cf. Jakobsen*, 520 F.2d at 813 (referring favorably to the no-prejudice test), since we find that neither the *Coffey* nor the *Ramirez-Rivera* standard was met here. In the present case, the limitations of remedies issues was not raised until virtually the end of the liability trial, after discovery and the submission of all of the evidence on liability. Nor did the parties' presentation of witnesses or documents focus on this issue. Rather, the magistrate judge's ruling seems to have derived from a fragment of testimony from one witness: a former Knapp executive named John Esser testified that he had told the Knapp president in July 1989 that Sylvania "[had] agreed and will agree, if we do have a claim, to take back any shoes, and always have."

This is pretty thin stuff, even coupled with evidence from other sources that the parties had extensive arrangements for the return of defective goods in exchange for credit. The question, after all, is not whether credits were an available remedy but whether the parties had agreed that credits were the excusive remedy. *See* Mass. Gen. Laws Ann. c. 106, § 2-719(1)(b) (quoted in note 4 above). More to the point, Esser's statement in context was not elicited by Sylvania to show that credits were the exclusive remedy, nor did Knapp cross-examine in order to refute such a suggestion, which after all Sylvania had not previously made. Thus, the parties did not litigate the limitation of remedies issue in the liability phase of the trial.

Nor was the issue litigated in the damages phase. Although in this phase the magistrate judge adverted to the limitation of remedies issue, his brief remarks suggest not that it was now open to litigation but rather that the parties either had or should have addressed the issue in the liability phase of the trial.[6] One can argue as to whether the limitation of remedies issue is better described as a liability or a damage issue. But in this case, the issue was not litigated in the former phase and it would have taken a fortune teller to suppose that such evidence would be welcomed in the latter phase.

In sum, we conclude that Sylvania waived the limitation of remedies defense by failing to assert it in the answer or by amendment in accordance with Rule 8(c). The defense was not resurrected either by clear notice given prior to trial or by actual litigation of the issue in the course of trial. Thus, the limitation of remedies defense is out of the case and cannot support the order vacating the injunction.

III.

Sylvania argues that the order under review may, in the alternative, be upheld because on the magistrate judge's finding that only a very small percentage of the shoes manufactured by Sylvania for Knapp were defective. If only a very small fraction of the shoes made by Sylvania for Knapp were defective, it might well follow that the damages claimed by Knapp were wildly excessive and that the injunction was no longer needed or ought to be reduced in amount. After all, practically

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[6] On the first day of the damages trial the magistrate judge, in ruling on an *in limine* motion by Sylvania to limit evidence, said that the motion was granted "to the extent it's already [*sic*] on what type of remedy is available as opposed to what damage is suffered." In a written order the next day, the magistrate judge — speaking of the liability phase — said: "An overriding issue — recognized, or which should have been recognized by the parties — was and is whether parties agreed to limit their respective remedies. . . ."

all of the types of damage claimed in Knapp's complaint (and recited above) depend as a practical matter on the premise that a large percentage of the shoes were defective.

But in this case we have no way to review or sustain the critical determinations — that the defective shoes were a very small quantity — about three percent — because there are no supporting findings by the magistrate judge. Fed. R. Civ. P. 52(a) requires that "in granting or refusing interlocutory injunctions the court shall . . . set forth the findings of fact and conclusions of law which constitute the grounds of its action." This requirement, which also attaches to the court's own final decision in a jury waived trial, *id.*, but not to most other rulings, *id.*, reflects the importance of injunctions and of providing an adequate basis for their appellate review.

Sylvania argues that Rule 52(a) is not applicable to this case because the rule, by its terms, applies only to decisions "granting or refusing interlocutory injunctions." Although there is some general support for Sylvania's position, *see Baltimore & O. R.R.* v. *Chicago R. & T. R.R.*, 170 F.2d 654, 659 (7th Cir. 1948), *cert. denied*, 336 U.S. 944 (1949); *Munoz* v. *Porto Rico Ry. Light & Power Co.*, 83 F.2d 262, 270 (1st Cir.) (construing Equity Rule 70 1/2, the precursor of Fed. R. Civ. P. 52(a)), *cert. denied*, 298 U.S. 689 (1936), both the cases cited involved the district court's *refusal* to dissolve a preliminary injunction. We agree that where a court made adequate findings when granting the preliminary injunction in the first place, it need not restate those findings in order to maintain the injunction.

A decision to *vacate* an existing preliminary injunction is quite another matter. It is not only a substantial change in the status quo but is the effective equivalent of a *denial* of a preliminary injunction, an event that unquestionably triggers Rule 52(a)'s requirement of findings. We do not think that it

stretches Rule 52(a) unduly to apply it to an order vacating a preliminary injunction. But the need for findings in such a case is so strong that we would impose the findings requirement ourselves if we thought that Rule 52(a) had left an inadvertent loophole.

Given our conclusion that Rule 52(a) findings were required, we cannot sustain the order vacating the injunction in this case on the alternative ground offered by Sylvania, namely, the small percentage of defective shoes. The magistrate judge did not rely at all on Sylvania's alternation ground. Instead, in a footnote sentence at the close of the certification, the magistrate judge observed in explaining the questions being certified: "[T]he plaintiff has shown that three (3) percent of the shoes were allegedly defective." We do not think that this sentence is sufficient for purposes of Rule 52(a).

Admittedly, the case law lays down few clear rules as to what is adequate compliance with Rule 52(a). We have said that "conclusory findings" are not enough, *Thermo Electron Corp.* v. *Schiavone Construction Co.*, 915 F.2d 770, 773 (1st Cir. 1990), but also that "the 'judge need only make brief, definite, pertinent findings and conclusions upon the contested matters; there is no necessity for over-elaboration of detail or particularization of facts.' " *Applewood Landscape & Nursery Co.* v. *Hollingsworth*, 884 F.2d 1502, 1503 (1st Cir. 1989). The difficulty in devising a yardstick is not surprising when one considers the great diversity of disputes governed by the rule.

In the abstract, one might or might not describe as "conclusory" a magistrate judge's statement that the shoes delivered by Sylvania to Knapp had a defect rate of about three percent: the statement is specific and concrete, but unexplained. In truth, pinning a label like "ultimate" or "conclusory" on a single sentence is not very helpful; Rule 52(a) calls for a level of

detail *adequate* to permit appellate review on factual issues, and what is adequate depends on the importance of an issue, its complexity, the depth and nature of evidence presented, and similar elements that vary from case to case. *See generally Kelley* v. *Everglades Drainage District*, 319 U.S. 415, 420 (1943).

Here the percentage of defects is critically important. Of course, the magistrate judge could not know that his own basis for dissolving the injunction would be set aside and that Sylvania would rely on the percentage finding to support the dissolution order. But to the extent that the three percent finding is proffered by Sylvania as a foundation for the dissolution order, it must meet the test of Rule 52(a). For this purpose, the importance of the issue requires more rather than less detail.

In this case there is no detail whatever. We do not know how the magistrate judge defined "defect," a disputed issue at trial, nor how he arrived at the three percent figure, nor how he handled Knapp's claim that the percentage of shoes actually returned to Sylvania greatly understated the percentage of defects.[7] On all of these issues there is no indication as to why certain witnesses were credited, what data was used or how it was construed, or why competing evidence was rejected. We are thus unable to make a reasoned judgment whether, on this critical issue of defects, the magistrate judge's finding was or was not "clearly erroneous." Fed. R. Civ. P. 52(a).

In fairness to the magistrate judge, we note that he did not make the "approximately three (3) percent" finding either to support a final determination of damages (which has not yet occurred) or to support dissolution of the preliminary injunction

[7] Knapp claimed that many of the defective shoes were simply disregarded by customers and that other shoes, which Knapp sought to return to Sylvania as defective, were not accepted by Sylvania.

(it is Sylvania who is trying to make the finding play that role). Rather the footnote finding was made to flesh out a hypothetical statement in the body of the certification. There is no requirement for Rule 52(a) findings in certifying a legal question to a state court.

IV.

The trial in this case concluded on November 25, 1991, a year and a half before entry of the interlocutory order that forms the basis of this appeal and over two years prior to the present decision. We see little point in remanding this case for further findings with respect to the district court's order dissolving the preliminary injunction. In our view, the energies of both the court and the litigants would be more fruitfully directed toward a final resolution of this case on the merits.

Sylvania is, of course, free to file a new motion to dissolve the preliminary injunction. But unless it can show some urgent need for the release of the funds, we would expect the magistrate judge to refuse summarily to revist the preliminary injunction until the final decision is issued. Knapp's case was once thought to have enough merit to justify an injunction; as yet there are no *supported* findings that warrant a reappraisal of potential damages; and Sylvania is apparently in the process of distributing all of its unencumbered assets.

As for the certification, it relates only to the limited issue of attorney's fees under c. 93A. Possibly the Supreme Judicial Court will have answered the questions posed by the time the magistrate judge is ready to issue his decision on the merits. If not, the magistrate judge may think that the wiser course, in litigation that has otherwise been ripe for resolution at least since March 1992, is to decide the whole case and make his best conjecture on the c. 93A issues.

One final issue remains. In the order vacating the preliminary injunction, the magistrate judge also dissolved the attachment on trustee process. An attachment on trustee process is an interim remedy that was used here to prevent certain persons owing funds to Sylvania from disbursing them to Sylvania, in effect protecting funds that might be use to satisfy a judgment for Knapp. *See* Mass. Gen. Laws Ann. c. 246, § 1; Fed. R. Civ. P. 64; Mass. R. Civ. P. 4.2. Our stay pending review kept both the injunction and the attachment in effect until disposition of this appeal.

Sylvania argues that the dissolution of the attachment is not equivalent to the dissolution of a preliminary injunction and is not an appealable event. Knapp argues that the attachment is appealable, citing *Teradyne, Inc.* v. *Mostek Corp.*, 797 F.2d 43, 44-47 (1st Cir. 1986), but we see no reason to resolve this issue. The magistrate judge's *rationale* for dissolving both the injunction and the attachment was the same. As we have found that rationale to constitute legal error, we assume that the magistrate judge will on his own motion maintain the attachment in force unless and until there is a proper basis for modifying.

Sylvania says that the funds under the attachment have been earning no interest for two years. If the funds are unequivocally owing to Sylvania, there should be an easy means for dealing with this problem (*e.g.*, by an arrangement transferring the funds to an interest bearing account subject to the attachment). Nothing in this opinion prevents Sylvania from applying to the magistrate judge for a modification of the attachment to address this or any other problem pertaining to the attachment.

The magistrate judge's order dissolving the preliminary injunction is *vacated*.

APPENDIX F

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 95-1220

KNAPP SHOES, INC.,
PLAINTIFF-APPELLANT,

v.

SYLVANIA SHOE MANUFACTURING CORP.,
DEFENDANT-APPELLEE.

Before
Cyr, Boudin and Lynch

ORDER OF THE COURT

Entered: January 12, 1996

Upon consideration of the appellant's "Petition for Rehearing," it is ordered that said petition for rehearing is hereby denied.

By The Court

/s/_____
Acting Clerk

[cc: Messrs. Bonn and Green]

APPENDIX G

STATUTORY SECTION AND PROCEDURAL RULES INVOLVED

UNIFORM COMMERCIAL CODE
Massachusetts General Laws, Chapter 106, Section 2-715

§ 2-715 Buyer's Incidental and Consequential Damages

(1) Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.

(2) Consequential damages resulting from the seller's breach include

(a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and

(b) injury to person or property proximately resulting from any breach of warranty.

FEDERAL RULES OF CIVIL PROCEDURE

Rule 8. General Rules of Pleading

(c) Affirmative Defenses. In pleading to a preceding pleading, a party shall set forth affirmatively accord and satisfaction, arbitration and award, assumption of risk, contributory negligence, discharge in bankruptcy, duress, estoppel, failure of consideration, fraud, illegality, injury by fellow servant,

laches, license, payment, release, res judicata, statute of frauds, statute of limitations, waiver, and any other matter constituting an avoidance or affirmative defense. When a party has mistakenly designated a defense as a counterclaim or a counterclaim as a defense, the court on terms, if justice so requires, shall treat the pleading as if there had been a proper designation.

Rule 52. Findings by the Court; Judgment on Partial Findings

(a) Effect. In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon, and judgment shall be entered pursuant to Rule 58; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. It will be sufficient if the findings of fact and conclusions of law are stated orally and recorded in open court following the close of the evidence or appear in an opinion or memorandum of decision filed by the court. Findings of fact and conclusions of law are unnecessary on decisions of motions under Rule 12 or 56 or any other motion except as provided in subdivision (c) of this rule.